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HISTORY OF ECONOMIC THOUGHT

A CRITICAL ACCOUNT OF THE ORIGIN AND DEVELOPMENT OF THE ECONOMIC THEORIES OF THE LEADING THINKERS IN THE LEADING NATIONS

BY

LEWIS H. HANEY

PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY
AUTHOR OF *Value and Distribution*

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PREFACE

The chief change made in this edition consists in the addition of five new chapters which deal with Wicksell (whom I treat as a Neo-Classicist), Cycle Theory, Limited-Competition Theory, Keynes, and General-Equilibrium Theory (in connection with which I briefly discuss Econometrics). Thus I both round out the body of Neo-Classical thought, as a stage in the evolution of economics, and begin the account of the critics of Neo-Classicism, whose criticisms will in due course lead to a new Neo-Classicism. (What form I hope this new Neo-Classicism may take is indicated by a few words concerning my own theory of *Value and Distribution*, Chapter XXXIX.)

In addition, I have attempted to bring up to date my previous sketches of the main developments in European economic thought, by nations. And in the chapter on the United States, considerable new material will be found, such as the brief discussion of New Welfare Economics. Together with the chapters which deal with "Institutionalism" and with "Monopolistic Competition," and the section on Econometrics, the student may find a reasonably adequate account of American economic thought.

No change of importance has been made in the chapters down to that on Marshall. Throughout, an effort has been made to retain all material that is sound and true, letting the history grow. One result of this procedure is that possibly too much space relatively has been given to recent developments. A hundred years from now, some things which seem in the present worthy of a chapter may be dismissed with a paragraph. But who among us can yet say which ones?

Never has there been greater need of a close examination of history, and especially the history of economic thought. Apparently "new" and strange doctrines, considered by many to be "revolutionary," have rapidly become prominent. Totalitarianism, defeated in battle, gains ground in the macro-economics. The Neo-Mercantilism of the national-income approach is widely accepted.

Certainly, times are different from the days of 1936, when the third edition of this work appeared. Then the ideal of democracy still dominated policy in much of the world, and Neo-Classical economics prevailed, challenged in the United States only by Institutionalism and monopolistic-competition theory. And private enterprise was paramount. Now Nationalism and more or less collectivistic schemes of varying shades are prevalent. The subjectivist economics of mathematical "general-equilibrium" are widely discussed, as implementing Keynesian, Neo-Marxian, and New Welfare formulae for a centrally-managed economy. To an increasing extent, private enterprise is replaced or limited by central government control.

Value Economics is being subordinated to price economics.

In some current histories of economic thought, elements of bias are observable. The Marxian dwells on Marx. The Frenchman is apt to dwell on French economics, hardly mentioning German thought. The Englishman may be bounded by Marshall and Keynes. Particularly dangerous is the specious argument in favor of dealing with theories rather than with theorists. In no field of knowledge is thought so molded by the thinker and his environment as is the case with economics; and it is therefore always desirable to know something about circumstances. To this end, an effort has been made to present briefly such circumstances, biographical or historical, as may help one to understand the main economists or schools of thought without causing the reader to lose the thread of logical continuity.

No one can hope to escape entirely from bias; but it has been my earnest endeavor to be a true historian, and in this endeavor I have some advantage in that I am of no "school," and cannot truly be said to belong to any of the "isms." My first study of economics was Ingram's *History of Political Economy*. I was then exposed successively to Welfare Economics, Neo-Classicism, Austrian School, and Historical School doctrines. I find some truth in all. I find complete truth in none.

The following excerpts from the prefaces to the earlier editions may serve to explain further the nature and scope of the present work:

It is the aim of this book to present a critical account of the whole development of economic thought in the leading nations of the Occidental world; and, while keeping the purely economic viewpoint, to indicate some of the most important relations of economic thought with philosophy and environmental conditions. As it is designed to serve as a textbook for the growing number of advanced students who study the history of Economics, every effort has been made to give a fair and well-rounded account of the thought of the leading writers.

Doubtless there will be some difference of opinion about the relative space here devoted to the different economists, and some cases of omission or bare mention will be criticized. It should therefore be stated that a twofold test has been the basis of selection in this regard: first, what has been the writer's effect upon the stream of economic thought? Next, what important point in theory has he originated or developed? If his contribution has been both discovery in theory and a profound effect on his contemporaries, then he deserves considerable discussion. These two phases of importance do not necessarily go together, as the experience of Lloyd, Gossen, and others bears witness.

In covering so vast a field it has seemed desirable to standardize the method of treatment to some extent. Accordingly, the general plan of procedure in dealing with an individual economist has been first to indicate briefly the pertinent circumstances of his environment, both objective and subjective; then to discuss his economic thought under the heads of value theory, and the shares in distribution; concluding with a statement of his logical method and philosophy. Any noteworthy point which is associated with an economist's name has generally received attention. In a word, value and distribution have been emphasized, but are far from being the only topics treated.

Finally, it will be observed that after Adam Smith the chronological development of the subject has been sacrificed to some extent for the sake of a more topical arrangement. It is believed that the analysis followed will lend far more to the interest and intelligibility of the history than would be required to offset this sacrifice.

To some, it seems that the great World Wars have brought conditions which call for a revolution in economic thought. This may be doubted; but however that may be, the importance of an understanding of the evolution of the economic doctrines now prevalent is but accentuated. The student of these pages will find Mercantilist and Nationalist doctrines; he will find Communism and Socialism; he will find the historical and institutional points of view. He will find that there have been other "revolutions," and that there is little under the sun which is entirely new — least of all, in economic error. What mistakes of past economists are not duplicated in the theories of the living?

I wish to acknowledge helpful advice received from Ludwig Mises, Theo Suranyi-Unger, Edward Chamberlin, and David McCord Wright. It was Suranyi-Unger who stimulated me to undertake the revision.

Above all, however, is my debt to my wife, Louise Thion Haney, who not only has given me without stint the usual help in checking references and proofreading, but also has shown great ability as a critic. I regard her as an authority on Keynes. Her devoted assistance appears on every page.

LEWIS H. HANEY.

NEW YORK CITY

OUTLINE OF TABLE OF CONTENTS

PAGE
A. GENERAL INTRODUCTION 1
I. NATURE AND IMPORTANCE OF THE HISTORY OF ECONOMIC THOUGHT 3
II. THE ORIGIN AND TARDY DEVELOPMENT OF ECONOMIC THOUGHT 28

B. ECONOMIC THOUGHT BEFORE THE SCIENCE OF ECONOMICS 35
I. ECONOMIC THOUGHT OF THE ANCIENTS 37
II. MEDIEVAL ECONOMIC THOUGHT 88
III. THE DAWN OF MODERN ECONOMIC THOUGHT: MERCANTILISM AND KAMERALISM 109

C. THE EVOLUTION OF ECONOMICS AS A SCIENCE . 166
I. THE FOUNDERS 169
II. THE EARLIER FOLLOWERS 243
1. Utilitarianism 245
2. Pessimistic Tendencies 256
3. Optimistic Tendencies 313
4. Other Expositors 341
a. In England 343
b. The Expositors of the English Classical Political Economy Outside of England: 1776–1850 . . . 351
III. OPPONENTS AND LEADING CRITICS 375
1. The Philosophical and Ethical System 377
a. Individualistic Critics 379
b. Nationalistic Critics 403
c. Socialistic Critics 425
IV. THE RESTATEMENT 441
V. OPPONENTS AND LEADING CRITICS (*resumed*) 477
1. The Philosophical and Ethical System (*resumed*) . . 477
a. Socialistic Critics (*resumed*) 479

PAGE
2. The Scope and Method 509
   a. Critics of the Scope of Classical Economics . . 513
   b. Critics of the Method 523
3. The Logic 553

VI. ATTEMPTS AT RECONSTRUCTION 579
1. Subjectivism and Marginism 581
   a. Earlier Developments in the Marginal-Utility Concept 587
   b. Fully Developed Subjectivism: The Austrian School 607
2. Neo-Classicism 635
   a. Alfred Marshall's Synthesis 637
   b. Wicksell and the Swedish School 658

VII. CRITICS OF NEO-CLASSICISM 665
1. Development of Business Cycle Theory 667
2. Monopolistic and Imperfect Competition Theory . 695
3. Veblen and Institutionalism 718
4. Keynes and His Policies 734
5. "General-Equilibrium Economics" and Econometrics 781

VIII. A SYNTHESIS 803

D. GENERAL ACCOUNT OF RECENT LEADING SCHOOLS 809

I. DEVELOPMENTS IN ECONOMIC THOUGHT IN THE PERIOD OF DECLINING PRICES AND GROWING NATIONALISM: 1874–1933 811
1. Germany and Austria 813
2. Italy 832
3. France (and Belgium) 846
4. England 860
5. United States 876

E. GENERAL APPRAISAL 905
1. The Evolution of Economics Epitomized 907
2. The Light of the Past: Conclusion 941

F. BIBLIOGRAPHY 951
1. American Economists, Active between 1850 and 1915 . 951
2. Works on the History of Economic Thought 966

TABLE OF CONTENTS

A. GENERAL INTRODUCTION

PAGES

PREFACE . . . . v–viii

CHAPTER I. NATURE AND IMPORTANCE OF THE HISTORY OF ECONOMIC THOUGHT 3–27

Scope of the Subject — Relation to Industrial History — Reasons for Studying It — 1. Underlying Philosophies, Materialism, Idealism — 2. Method, Inductive, Deductive, Statistical — Absolutism in Thought — Comte's "Stages."

CHAPTER II. THE ORIGIN AND TARDY DEVELOPMENT OF ECONOMIC THOUGHT 28–34

Origin in Moral Codes — Reasons for Tardy Development: Subjective, Objective.

B. ECONOMIC THOUGHT BEFORE THE SCIENCE OF ECONOMICS

I. ECONOMIC THOUGHT OF THE ANCIENTS

CHAPTER III. ORIENTAL ECONOMIC THOUGHT, ESPECIALLY THE CONCEPTS OF THE HEBREWS AND HINDUS . . . 39–55

Generalizations concerning Orientals Limited — Purpose of the Chapter—Economic Thoughts Found in Laws, etc. — Usury — Commercial Regulations and Just Price — Labor and Caste — Agriculture Favored — Seventh and Jubilee Years — Summary Generalizations: Simple Social Philosophy, Religion and Morals Dominant, Minute Regulation, Conflict with Economic Motives, Fixity and Conservatism, Concept of Society.

CHAPTER IV. THE ECONOMIC THOUGHT OF ARISTOTLE AND PLATO 56–72

Origin of the State — Division of Labor — A Social Point of View — Inheritance — Population — Communism — Scope and Classification of Aristotle's Economic

PAGES

Thought, *Oikonomik*, *Chrematistik*, "Natural" Occupations — Money and Interest — Agriculture Favored, Money-Making Condemned — Riches Deplored — Stoics — Epicureans — Ethics Dominant — Summary — Contrast with Hebrews and Hindus.

CHAPTER V. THE ECONOMIC THOUGHT OF THE ROMANS . . 73–87

Introduction — The Jurists: Natural Law, Private Property and Contract — Money and Interest — The Philosophers: Ethical Notions, Interest — Quietism and Nature Philosophy — Agriculture Favored — Practical Tendencies — The Writers on Agriculture, *Lati Fundia*, Slavery — Value — Regulation of Industry and Commerce — Influence of Roman Thought — Division of Labor — Summary — Appendix: Quotations from Writers on Agriculture.

II. MEDIEVAL ECONOMIC THOUGHT

CHAPTER VI. THE MIDDLE AGES 91–108

The Period Defined — Germanic Contributions — Christianity and the Church — Scholasticism and Canon Law — Thomas Aquinas — Value and "Just Price" — Usury — Functions of the State — Monasteries — The Towns — Gilds — General Significance of the Period: Transition to National Economy, Authority, Duty.

III. THE DAWN OF MODERN ECONOMIC THOUGHT: MERCANTILISM AND KAMERALISM

CHAPTER VII. MERCANTILISM 111–147

Preliminary Definition — Factors Explaining Mercantilism — The More Remote: Reformation, Humanism, Utopia — The More Immediate: Exchange, Competition, Taxation, Internal and External Problems — Policies and Theories: "Treasure," Foreign Trade, Balance of Trade — Means of Insuring a Favorable Balance — Land Bank Schemes: John Law — Practical Applications — Economic Theories: Value, Interest, Population, Wages, Rent, Factors of Production — Productivity of Occupations, Taxation — James Steuart, "The Last of the Mercantilists" — Philosophy — Critical Estimate and Summary — Mercantilism after the World War — Appendix: German Mercantilist Policies.

PAGES

CHAPTER VIII. EARLIER GERMAN MERCANTILISTS AND KAMERALISTS 148-165

Nature, Scope, and Development — Some Typical Kameralists: Bechers, Hornig, Daries, Justi — Regalian Rights — Kameralism *vs.* Mercantilism — Summary.

C. THE EVOLUTION OF ECONOMICS AS A SCIENCE

I. THE FOUNDERS

CHAPTER IX. THE PHYSIOCRATS AND THE REVOLUTION IN SOCIAL PHILOSOPHY 171-206

The "Rule of Nature" — The Forerunners: Boisguillebert, Vauban, Fénelon, Cantillon — Forces Giving Rise to Physiocracy — Outline of Physiocratic Doctrine: Nature Philosophy, *Produit Net,* Value, Classes and Distribution, *Tableau Économique* — Wages and Interest, Population, Single Tax — Chief Physiocrats — Philosophy — English Followers — Critics — Practical Influence — Critical Estimate and Summary.

CHAPTER X. ADAM SMITH, HIS IMMEDIATE PREDECESSORS, AND THE REVOLUTION IN INDUSTRY 207-242

Immediate Predecessors: Mandeville, Hutcheson, Hume, Tucker, Ferguson, Harris — Life and Relations with the Physiocrats — The *Wealth of Nations* — Importance of Labor — Division of Labor — Value — Classes and Their Interests — Wages — Profits and Interest — Rent — Public Finance: Canons of Taxation — Government Interference: *Laisser Faire* — Philosophy and Method — Practical Influence — The Manchester School — Critical Estimate.

II. THE EARLIER FOLLOWERS

1. UTILITARIANISM

CHAPTER XI. BENTHAM AND HIS "PRINCIPLE OF UTILITY" . 247-253

Life and Works — Hedonism — Utilitarian Ethics — *Laisser Faire* — Rationalism — Social Reform — Benthamism *vs.* Smithianism.

PAGES

2. PESSIMISTIC TENDENCIES

CHAPTER XII. MALTHUS AND THE THEORY OF POPULATION 257–282

Life and Circumstances — Forerunners — The *Essay on Population:* Origin and First Edition — The Malthusian Principles: (1) Tendencies of Population and Subsistence, (2) Diminishing Returns, (3) Checks to Population — Social Results; the Malthusian Cycle — Other Economic Views — The Philosophy of Malthusianism — Critical Estimate — Bibliographical Note on Early English Controversies concerning the Population Question.

CHAPTER XIII. RICARDO AND THE THEORY OF DISTRIBUTION, ESPECIALLY THE RENT DOCTRINE 283–311

Life and Circumstances — Chief Writings — The *Principles of Political Economy:* Value, Value *vs.* Riches, Distribution, Rent, Wages, Profits and Interest — Surpluses — Money and Foreign Trade — Philosophy and Method — Followers: James Mill, M'Culloch, De Quincy.

3. OPTIMISTIC TENDENCIES

CHAPTER XIV. CAREY AND THE "AMERICAN SCHOOL" . . 315–329

Introduction — Predecessors: Franklin, Hamilton, Raymond, Everett, Phillips — Carey's Life and Works — Value — Social Progress and Distribution — Rent — Population — Philosophy and Method — Inconsistency — Carey's Followers: Early American School, E. P. Smith, Greeley, etc.

CHAPTER XV. BASTIAT AND THE FRENCH OPTIMISTS . . . 330–340

Life and Writings — Economic Harmony: Value, Labor and Capital, Land Value, Population, Government Intervention — Bastiat and Carey — Criticism — The Manchester Party.

4. OTHER EXPOSITORS

a. In England

CHAPTER XVI. SENIOR AND THE ABSTINENCE THEORY . . 343–350

An Outline of Political Economy — Scope — Abstinence and Capital — Cost *vs.* Expense; Past *vs.* Present Labor — Utility and Demand — Monopoly Theory — Wages — Increasing Returns — Emphasis of the Subjective — Critical Estimate.

PAGES

b. The Expositors of the English Classical Political Economy Outside of England: 1776–1850

CHAPTER XVII. SAY, RAU, AND OTHER CHIEF EXPOSITORS IN GERMANY AND FRANCE 351–360

Introduction — I. *Germany:* Nebenius — von Thünen — Rau — Services of Early German Economists — II. *France:* J. B. Say, His Arrangement of the Science, Theory of Markets, Value — Cournot — Dunoyer.

CHAPTER XVIII. VON THÜNEN AND *THE ISOLATED STATE* . 361–373

Method and Plan of Work — Rent — Price and Value — Wages and Interest, Marginal Productivity Theory — Tariff — Other Views — Conclusion.

III. OPPONENTS AND LEADING CRITICS

1. THE PHILOSOPHICAL AND ETHICAL SYSTEM

a. Individualistic Critics

CHAPTER XIX. LAUDERDALE AND RAE AS INDIVIDUALISTIC CRITICS: SOCIAL AND INDIVIDUAL WEALTH 381–388

Lauderdale — Definitions — Public Wealth *vs.* Private Riches — His Influence — Rae — Individual *vs.* Social Capital — Invention — Government Interference — Criticism of Smith's Method — Summary.

CHAPTER XX. SISMONDI: THE EMPHASIS ON INCOME AND CONSUMPTION 389–401

Life and Works — Economic Thought: Scope of Economics, Criteria of Progress, Scheme of Distribution, Overproduction and Machinery, Population, Reforms Advocated, Exploitation of Labor, Socialism — Method — Influence — Conclusion.

b. Nationalistic Critics

CHAPTER XXI. MÜLLER, LIST, AND CAREY: THE EARLY NATIONALISTS 403–424

The Nationalists and Their Background — Fichte — Adam Müller: Views on Protection, the State, Value, Capital — Criticism of Smith — Friedrich List: His Life, the *National System*, Criticism of "The School," Historical Views, Division of Labor, Immaterial Capital, Absolutism — Henry C. Carey: His Argument for Protection — Summary.

PAGES

c. Socialistic Critics

CHAPTER XXII. EARLY NINETEENTH CENTURY SOCIALISM 425–440

The Utopian or Bourgeois Socialists: Saint-Simon and the Saint-Simonists, The Associationists (Owen, Fourier, Thompson) — The Transition to a More Realistic and Proletarian Socialism in France, 1840–1848: Louis Blanc and Proudhon — Summary.

IV. THE RESTATEMENT

CHAPTER XXIII. JOHN STUART MILL 443–475

Life and Works — *The Principles of Political Economy* — Value — The Shares in Distribution, Rent, Wages, Profits — Consumption and Production — International Trade — Influence of Progress on Distribution — The Social Question — Unearned Increment — Government Interference — Philosophy and Method — Summary Appraisal.

V. OPPONENTS AND LEADING CRITICS (*Resumed*)

1. THE PHILOSOPHICAL AND ETHICAL SYSTEM (*Resumed*)

a. Socialistic Critics (*Resumed*)

CHAPTER XXIV. THE RISE OF "SCIENTIFIC" SOCIALISM . . 479–507

1. *State Socialism:* Rodbertus, Labor Productivity, Decreasing Wage Share, Rent, Distributive Justice, Crises, Remedies Proposed, Criticism of Ricardo's Rent Theory — Lassalle, Scheme of Reform, Capitalism, Conjuncture — 2. *International Revolutionary Socialism:* Marx and Engels — Karl Marx: Materialistic Interpretation of History, Capital and Exploitation, Surplus Value — Criticism — 3. *Revisionists and Opportunists* — Recent Developments: Syndicalism, Gild Socialism — Philosophy and Socialism — Influence of the Socialists: Primary, Secondary — Appendix: Early Effects of Socialism upon Economics.

2. THE SCOPE AND METHOD

a. Critics of the Scope of Classical Economics

CHAPTER XXV. THE ADVOCATES OF A NARROW EXCHANGE-VALUE ECONOMICS 513–521

Antecedents: Physiocrats, Whately, etc. — Bastiat — MacLeod — Similar Recent Tendencies — Summary.

PAGES

b. *Critics of the Method*

CHAPTER XXVI. CONCRETE-HISTORICAL CRITICISM IN GREAT BRITAIN 523–536

Introduction — Richard Jones: Abstract Assumptions Criticized, Ricardian Rent Theory, Method — Walter Bagehot: Scope and Method, Criticism of Classical Economics — Leslie: Opposition to Abstract *a priori* Methods, Realism, Class Interests, Anti-Utilitarianism, Negative Character of His Work — Ingram — Toynbee: Relativity, Optimism — Rogers — Summary.

CHAPTER XXVII. THE GERMAN HISTORICAL SCHOOLS . . 537–551

Circumstances Giving Rise to Historicism — General Nature and Main Branches — The Older or More Negative Group: Roscher, Hildebrand, Knies — Roscher's Program — Hegelianism — Hildebrand's Criticism — Knies on Absolutism, Criticism of Roscher, The Nature of Economic Laws — The Younger or More Positive Group: Schmoller — The *Verein für Socialpolitik* — Bücher — Schäffle — Recent Tendencies — General Summary and Critical Estimate.

3. THE LOGIC

CHAPTER XXVIII. LAUDERDALE AND HERMANN: EARLY CRITICISM OF THE THEORY OF CAPITAL, PROFITS, AND VALUE 555–569

Lauderdale's Criticism of the Theory of Capital and Profits — His Doctrines of Value and Consumption — Hermann and Other German Economists on Capital — Undertakers' Gains — Hermann's Criticism of Current Economics — Capital — Rent and Wages — Undertakers' Gains — German Industrial Conditions — Hufeland, Rau, Mangoldt — Consumption and Value — Conclusion.

CHAPTER XXIX. THE DOWNFALL OF THE WAGES-FUND THEORY 570–578

Richard Jones — Longe — A Writer in the *North American Review* — Cliffe Leslie — Thornton — Mill's Recantation — Walker — Taussig — Significance of Wages-Fund Episode.

PAGES

VI. ATTEMPTS AT RECONSTRUCTION

1. SUBJECTIVISM AND MARGINISM

a. Earlier Developments in the Marginal-Utility Concept

CHAPTER XXX. GOSSEN, JEVONS, WALRAS, AND THE MATHEMATICAL SCHOOL 587–605

First Developments: Condillac, Bentham, Craig, Longfield, Lloyd, Thomas, Dupuit, Senior — Gossen — Jevons: Value Theory, Other Economic Theory — Walras — Cassel — Summary.

b. Fully Developed Subjectivism: The Austrian School

CHAPTER XXXI. MENGER, WIESER, AND BÖHM-BAWERK, AND ESPECIALLY THE DEVELOPMENT OF SUBJECTIVE THEORIES OF VALUE AND INTEREST 607–634

The Austrians and Their Value Theory: Menger: Economic Causation, Utility, Classes of Goods, Price Limits — Wieser: Source of Value, Imputation Theory, The Place of Cost — Böhm-Bawerk: Subjective Value, Objective Value, Costs — Interest Theories — Followers — Philosophy and Method — Critical Estimate and Summary — Marginal Utility.

2. NEO-CLASSICISM

CHAPTER XXXII. MARSHALL, AND HIS SYSTEM OF EQUILIBRIUM 637–657

Marshall's Background — Marshall's Economics: Value, Demand and Supply, Distribution — Philosophy and Method — Criticism.

CHAPTER XXXIII. WICKSELL AND THE SWEDISH SCHOOL . 658–664

Conditions and Antecedents — Wicksell's Main Theories — Interest and Prices — Savings and Investment — Influence — The Criticism — Final Appraisal.

VII. CRITICS OF NEO-CLASSICISM

CHAPTER XXXIV. THE DEVELOPMENT OF BUSINESS CYCLE THEORY 667–694

I. *Early Classical Period: "Crises":* Overproduction, Ricardo — Underconsumption, Malthus, Sismondi — Summary. II. *The "Capitalist Age": "Cycles":* A. Capital Goods Theories — 1. The "Cycle," Juglar, Jevons — 2. Overproduction of Capital Goods, (J. S. Mill, Spiethoff)

PAGES

— 3. Underconsumption due to Capitalist Practices (Marx, Hobson) — B. Investment Theories — 1. The Principle of Acceleration — 2. Partial Overinvestment Theories, Non-monetary (Aftalion, Pigou, Schumpeter, D. H. Robertson) — 3. Overinvestment Theories of Overproduction, Monetary (Mises, Hayek) — 4. Underinvestment Theories of Underconsumption, (Hawtrey, Keynes, Harrod) — Summary Analysis of Cycle Theories.

CHAPTER XXXV. MONOPOLISTIC AND IMPERFECT COMPETITION 695–717

Early Assumptions concerning Competition — Cournot and Duopoly — Marshall's Time and Thought — The Development of Limited-Competition Theory — Chamberlin's, "Monopolistic-Competition" Theory — Robinson's "Imperfect-Competition" Theory — Stackelberg and Others — General Characteristics of Limited-Competition Theory — Grounds of Difference among Limited-Competition Theorists — Criticisms and Limitations of Limited-Competition Theory — Final Appraisal.

CHAPTER XXXVI. VEBLEN AND INSTITUTIONALISM . . . 718–733

The Background — General Nature of Institutionalism — Two Main Groups — Veblen — Other Institutionalists, Mitchell — General Appraisal.

CHAPTER XXXVII. KEYNES AND HIS POLICIES . . . 734–780

Keynes's Life and Background — Keynes's Position in the Stream of Economic Thought — Contemporaries — Keynes's System of Economic Policy: Underlying Assumptions, Consumption Economics, Depression Economics, Disharmony of Interests, Interventionism, "Full Employment" Goal — The General Characteristics of the Keynesian System: Macro-Economics, "Monetary Economics," Income Economics, Circular-Flow Economics, Timeless Economics — Details of Keynes's Scheme: Propensities and Controls, The Determinants, The "Multiplier" Oversimplifications of Spending — "Secular Stagnation" and Controls — Value and Distribution — The Critics of Keynes's General Theory: Concise Summary of Attack — Followers, Particularly in the United States — Reasons for Great Influence — General Appraisal; Contributions, Shortcomings, Idealism, The Future.

PAGES

CHAPTER XXXVIII. "GENERAL-EQUILIBRIUM ECONOMICS" AND ECONOMETRICS 781–802

General Nature of Theory — Historical Background — The Leaders and Their Contributions: L. Walras — V. Pareto — D. H. Robertson — The Stockholm School — "Period Analysis" — J. R. Hicks — International Trade. Econometrics, National Income Approach — General Appraisal of General-Equilibrium Economics.

CHAPTER XXXIX. A SYNTHESIS 803–807

Early Suggestions — Basic Assumptions — Value Economics — A General Equilibrium — New Concepts of Marginal Utility and Cost — Distribution as Value — Time and Equilibrium — The Social Individual — Economics a Science.

D. GENERAL ACCOUNT OF RECENT LEADING SCHOOLS

I. DEVELOPMENTS IN ECONOMIC THOUGHT IN THE PERIOD OF DECLINING PRICES AND GROWING NATIONALISM: 1874–1933

CHAPTER XL. ECONOMIC THOUGHT IN GERMANY AND AUSTRIA FROM 1870 TO WORLD WAR II 813–831

Scope and Sub-Division of Economics — Method — Value Theory — Schools of Thought — Some Developments since 1900, Cycle Theory — Economics and Philosophy — General Characteristics.

CHAPTER XLI. ECONOMIC THOUGHT IN ITALY FROM 1870 TO WORLD WAR II 832–845

Developments to 1875 — Leading Economists 1875–1920 — Various Schools — Inter-War Period, Corporative Economics — Summary.

CHAPTER XLII. ECONOMIC THOUGHT IN FRANCE (AND BELGIUM) FROM 1870 TO WORLD WAR II 846–859

French " Traditionalism " — The Liberalists, Older and Younger — Interventionism and the Historical School — Influence of Sociology and "Positivism" — " Solidarity " — Cycle Theory, Aftalion, Simiand, Ansiaux — Summary and Recent Developments

PAGES

CHAPTER XLIII. ECONOMIC THOUGHT IN ENGLAND FROM 1870 TO ABOUT 1936 860–875

The End of Classicism, Cairnes — Neo-Classicism, The Cambridge School, Marshall, Edgeworth, Pigou — The Disintegration of the Cambridge School — Welfare Economics — The London School — Summary.

CHAPTER XLIV. ECONOMIC THOUGHT IN THE UNITED STATES: 1870 TO 1946 876–904

The Background — History to 1860, Protectionism and Optimism — 1860–1885, Classicism and Dogmatism — 1885, New Problems and German Influence — Marginal Utility — American Economic Association — Conditions at the Beginning of the Twentieth Century — J. B. Clark — S. N. Patten — Irving Fisher — F. A. Fetter — Taussig, Carver, Ely, Seligman, Davenport — Period of Criticism, 1918 — Younger Institutionalists and Monopolistic-Competition Theory, 1930–36 — Keynes Predominant, 1938 on, Subjectivism and Dynamics — The New Welfare Economics and Socialism — Leading American Economists since 1920 — Summary Observations.

E. GENERAL APPRAISAL

CHAPTER XLV. THE EVOLUTION OF ECONOMICS EPITOMIZED 907–940

General Résumé: The Pre-Scientific Period, Beginning of Scientific Economics, Classicism, Critics of Classicism, Neo-Classicism (Value Economics), Reaction from Neo-Classicism — Continuity and Environment — Main Points of Difference: Ethics, Optimism *vs.* Pessimism, Surplus, Cost *vs.* Utility, Subjective *vs.* Objective, Quantitative *vs.* Qualitative Values — The Present Condition and Trends, Philosophy and Method — Scope of Economics — Capital and Interest — Profits — Value.

CHAPTER XLVI. THE LIGHT OF THE PAST: CONCLUSION 941–949

The Great Cycle in Economic Thought — The Future: No Revolution — The Individual, Society, and the State — Price Economics *vs.* Value Economics — The Present: Economic Science Stands.

PAGES

APPENDIX

Chief works of American Economists active between 1850 and 1915 951–965

BIBLIOGRAPHICAL NOTES

Chief Bibliographical Sources; Leading Works in the History of Economic Thought 966–974

INDEX OF NAMES 975–986

INDEX OF SUBJECTS 987–996

A. GENERAL INTRODUCTION

CHAPTER I

THE NATURE AND IMPORTANCE OF THE HISTORY OF ECONOMIC THOUGHT

The words History and Economics are found in the names of at least three different branches of study. There is, on the one hand, Economic History, or Industrial History, as it is frequently called; and on the other, there are the closely related subjects, History of Economics and History of Economic Thought. The first concerns itself with the history of commerce, manufactures, and other economic phenomena, dealing objectively with the ways in which men get their living; the second and third treat primarily of subjective matters, dealing for the most part with the ideas men have concerning economic facts and forces.

Now these last two have been confused, and their logical relationship is commonly overlooked. The history of Economics deals with a science — with a body of classified knowledge based upon the establishment of certain uniformities in economic life, or the tendency of certain results to flow from given causes. It is limited to times in which economic ideas have become distinct, unified, and organized; it is a history of *systems* of economic thought. The Babylonians had ideas concerning interest and mortgages; the Phœnicians thought about commerce and bills of exchange; the Greeks wrote on the subject of division of labor. Does the history of Economics, then, extend to such remote times? By no means. But the history of "economic thought" does, and from its point of view the unrelated primitive ideas of the earliest times are full of meaning. Indeed, for a full understanding of the origin and growth of the science, the underlying ideas are important.

The history of economic thought is broader than the history of the science: it may properly be divided into two parts, one of which takes up the origin and development of economic ideas prior to the existence of any distinct and separate science; while the other begins with the rise of Political Economy, or the science of Economics. The point of view to be taken in the following pages is the broader one.

The subject, the History of Economic Thought, may be defined as a critical account of the development of economic ideas, searching into their origins, interrelations, and manifestations.

The close relationship between economic history and the history of economic thought is at once to be emphasized. That men's thoughts depend largely upon their surroundings, no one doubts. And so it is that economic ideas, to say nothing of systems of economics, are colored and limited — determined sometimes — by industrial environment. Thus the agricultural South believes in free trade; as manufactures develop, that belief weakens. But this interaction is reciprocal; for opinions and theories once formed are often tenaciously adhered to, and may become a determining element in their turn. They become fixed in "institutions." Witness the influence of "traditional policies" in shaping the platforms and administration of American political parties. The individualism of the *laisser-faire* economists and statesmen was to a great extent the result of industrial evolution; but in its turn it became a condition reacting upon industry.[1]

The history of economic thought, then, is an essential part of general history, both explaining it and being explained by it.

Today it is not so necessary to defend the study of the History of Economic Thought as it once was. Even now, however, there are those who deny the usefulness of studying earlier economic thought. And, in any case, it will be of value to state clearly the advantages to be gained from such a study as the present; for the statement may make one's reading more purposeful and suggest new points of view.

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[1] Through William Pitt (see p. 236) and Robert Peel, for example, and the economists of the dominant French school. The former were active in applying the *laisser-faire* doctrine to the corn laws; the latter did much during the nineteenth century, both as government officials and writers, to bring into practice their optimistic, let-alone theories. Of course, Pitt's accomplishments were very limited.

First of all, a certain unity in economic thought is to be emphasized, a unity which connects us with ancient times. Continuity in evolution has been denied,[1] but such continuity can be demonstrated. Much of the difficulty comes about through an exaggeration of the negative aspect of the Middle Ages. But such an exaggeration misinterprets the period, for the medieval aloofness or quietism implied a positive philosophy which has counted in the history of thought in a positive way. Nor was this period a complete break; in it were nourished Greek ideas concerning money and interest, communism, and other economic matters, — not to mention the "nature philosophy," — which were handed down to modern thinkers. The doctrines of the first economists concerning the importance of land and the beneficent law of nature were drawn through a continuous line of thinkers from Plato, Aristotle, and Zeno. As will appear further on, moreover, not only do Oriental ideas inherited from a still more remote past come down to us through Greece, but through Christianity they have exerted a continuous though changing effect upon the economic thoughts of men. It is logical, then, to begin a history with some account of ancient thought.

Again, there is great value in understanding the origin of a science, especially one like economics, the nature and scope of which have been under dispute. For one thing, it gives a truer concept of the relationship among sciences, an important matter for the thinker who seeks to specialize and to make a precise application of economic principles. Through a study of the history of economic thought, may be gained a clear realization of the position of Economics as a distinct member of a group of social sciences: Ethics, Jurisprudence, Politics, Sociology, and others. While it is properly concerned with man's efforts to get a living in association with his fellows, as a social science it is related to other sciences which deal with human wants or with the way men get their living. To illustrate one such relationship, it may be observed that to the extent that what is uneconomical becomes, on that account "wrong," Economics is directly related to Ethics. Sometimes men desire things because they are "beautiful," and then Economics touches Æsthetics. Often political considerations clash with considerations of cost and exchange value. Economists, as practical men, must realize that the sanctions of Economics coöperate or conflict with the sanctions of other social sciences, a fact which limits its application. There is, therefore, no better way for a student grounded in economics to find himself in the wider field of social science than to study the history of economic thought. For in the beginning social values were one. In the thought of the ancients, purely economic ideas may be apparent to us, but the men who had them did not differentiate.

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[1] **E.g., Oncken, A., *Geschichte der National Ökonomie*, pp. 15 f.**

Such having been the broad beginning, one may wonder if some cycle may not be completed when a scientific synthesis will again bring together feelings, desires, property, family, state, justice, law, happiness, and other concepts, on a rationally unified basis of valuation.

The concept of relativity, the point of view according to which ideas are not judged with dogmatic absolutism, but are critically examined in the light of the times and places in which they were formed, becomes very real. Before we can call medieval thinkers, blockheads, on the ground that they condemned interest-taking, we must examine their premises and the circumstances of those premises. Men being in part creatures of their environment, their thought is often guided and limited by the changing phenomena with which they are confronted.

Then, there is the value of a broad basis for comparison which such a study brings. Standing at the highest point yet reached, after centuries of economic thought, and looking back over the path of truth, strewn with fallacies and truisms though it be, the student feels his judgment broadened, and a well-balanced and reasonable conservatism, or a wise progressivism, may fill his mind. He is not so apt to be swept off his feet by fads, nor to be made confused and hopeless when controversies rage around him; for he knows that fads and controversies have come and gone, while so substantial a body of economic truth has been established that progress in it must come, not through revolution, but through evolution.

To the author, it seems that one of the most important benefits to be gained by studying economic thought lies in the realization that Economics is one thing, and economists are another. At any given time, we are apt to find discussions and differences of "opinion" among individual economists, often arising from personal interests, and generally centering on practical policies. These cause confusion, and the layman or student knows not what to believe. Even the trained economist may forget the real nature of his science and his task as a scientist. But Economics is different. The science has its body of "laws," which is the result of the work of many different economists — a synthesis of many different and conflicting theories. These abstract generalizations are the property of no economist, nor do they depend upon particular conditions. By considering the body of economic doctrine as it has grown through the centuries, one may rise above the squabbles among economists, and gain confidence in Economics. One may be able to take a sort of objective point of view.

Back of the different systems of economic thought, or even particular theories, there lie more fundamental factors which condition them and determine their nature and form. The most important of these factors are (1) the underlying philosophy and (2) the method of the thinker, which influence his interpretation of economic phenomena and the conclusions which he may draw. The philosophy and the method form part of a premise of the syllogism, as it were. One economist reaches one conclusion, another a different one. We say their points of view were different. But each point of view is made up of a certain basic philosophy of life, and a closely allied tendency to a certain methodology in thought.

Not the least service of a history of economic thought is the light it throws upon this question of point of view, and it is desirable here to sketch the historical outlines of philosophy and method as a background for the more detailed history of strictly economic thought which is to follow.

1. Philosophy. — Since the fifth century before Christ, two great tendencies in philosophy have ever opposed and reacted upon one another. These tendencies we may call respectively Idealism and Materialism, using the terms in a broad general sense, and with full recognition of the fact that the old metaphysical problem that they formerly denoted has become more complicated than was the case when they were first used. As here used, they will be taken to cover tendencies in thought, the tendency manifesting itself perhaps in metaphysics, perhaps in epistemology or psychology, perhaps in ethics or social science.

In a strict metaphysical sense, Idealism means the belief that matter has no independent reality, but is simply a presentation of the mind. The belief is rarely if ever found in so strict a sense, however, some room being generally allowed for a degree of independent existence of matter. This is dualism; but if a capacity to form judgments not dependent upon the material is recognized, and the importance of the peculiar constitution of our perceptive faculties is emphasized, it may be said that the tendency is toward idealism. In this sense, both Plato and Kant may be called idealists: Plato, in that he allows phenomena to be absorbed in ideas that are realities and believes in the reality of such abstract things as "goodness"; Kant, in that he held that the mind could produce genuine knowledge from its own resources. In fact, one of the most marked evidences of the tendency here called idealism, is found in the theory of the origin of ideas, or judgments, the idealistic tendency being indicated when a thinker holds that these may arise independently of sense data. This would seem to imply a belief that the true nature of things is intellectual not sensuous.

It follows that idealists attribute an independent force to ideas or judgments. They regard man, not as a creature of material environment, but as a more or less independent force, capable of adapting or conquering "nature." Accordingly, they emphasize unions of man in society as being manifestations of community of ideas, and the most effective way of asserting the power of ideals; and they readily become what may be called societists — to adopt a term that will cover the belief in the potency of social activity and institutions. For reasons that will become clear when materialism is considered, idealists tend to oppose egoism, and to favor its repression by the state as representing society. This tendency they may carry so far as to regard society as a true organism, in which the individual mind is subordinated to the social mind.

It seems to follow from these tendencies that idealists will logically defend social institutions, and consequently they are essentially conservative. Of course, to those who hold to the opposite philosophical tendency, they will seem to be the radicals and when, as in the United States in 1933, it is idealism which demands a "New Deal," the materialist becomes for the moment the conservative "standpatter." But as a rule it is those who believe in no supreme rational purpose or divine will, and who regard social institutions and perhaps society itself as shifting expedients based upon a mechanical individualism, who are apt to be the disturbers.

A practical expression of all this is the fact that idealistic thinkers stress morality and duty, and frequently set the good above the "natural." They are apt to appeal to abstract spiritual considerations. Indeed, ethical idealism, which has been one of the phases of idealism most influential in economic thought, is closely related to the more metaphysical idealism described above; Kant's ethics was idealistic, and the Golden Rule was based upon the assumption that the idea may be independent of the material environment. The idea of the Golden Rule is that the mind, as an independent factor, able to recognize the rights of other minds having other ideas, can decide what ought to be done, in spite of material limitations and clashes of interest.

Believing in innate ideas and reflective faculties, and their potency, idealists generally regard individual men as being inherently different in capacities.

Thus there is more in men than "common clay," and uniformities result from uniformities in ideas, such uniformities being something to strive for and perhaps to be attained by man-made law. But the idealist believes that man is more or less "perfectible" — by means of education or the influence of "proper institutions." Of course, man is held to be responsible for his own destiny. With responsibility goes the power, capable of multiplication by social coöperation, to make his own destiny "by taking thought." In a word, idealism stands for the independent importance of mind and human institutions as opposed to the material environment. The thoroughgoing idealist, too, must assume the existence of some divine mind or of a supreme world-purpose to explain the regularities of phenomena; for without some such system of determination acting as a coördinating force, all continuity and regularity would be dependent upon individual human minds.

In the ranks of idealists may be placed most Oriental thinkers; Plato and some of the Stoics, of antiquity; the Neo-Platonists, St. Augustine, and Thomas Aquinas, in the Middle Ages; Hugo Grotius in the seventeenth century; the Englishman, Berkeley; the German philosophers, Leibnitz, Kant, Schelling and Hegel, and the French thinkers, Malebranche and Comte, in more modern times.[1]

The materialistic tendency, on the other hand, not only regards matter as existing independently of mind, but may go so far as to deny the existence of anything but matter. If materialists do not go so far, they at least regard physical facts as determining mental processes. This tendency is logically associated with the theory that ideas come into existence only through the senses as stimulated by matter. Instead of assuming a supreme mind whose rational purpose dominates the world, they hold to a physical concept of nature and regard the world as ruled by laws of matter.

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[1] Naturally there are many points of difference among idealists, as some tend toward dualism (Plato) while others tend toward monism (Berkeley); some toward agnosticism (Kant and Comte), others not.

Naturally, therefore, materialists will tend to regard man as dominated by his natural environment, and we can see the reason why those who hold this philosophy are generally individualistic [1] and *laisser-faire.* If matter alone counts, then it is easy — to say the least — to believe that all men being made of the same clay, are naturally equal; and that, human choices being determined by sensations and acted upon by the same forces, men will tend to act in the same way.

The chief differences among normal individuals are thus apt to be attributed to environmental conditions, and idealistic doctrines as to the perfectability of man are countered by arguments that they are limited by material factors.

The state itself, far from being the expression of common ideas, is a mere aggregation of atomic individuals made necessary by the material nature of man (Hobbes).

Man cannot presume to dictate terms to nature; therefore, *laissez faire!* In any event, the forces of nature will at last have their way. Let things alone, that "nature" may freely rule and that the natural order may establish itself.

Thus, the cry often is: "Down with man-made institutions!" Under the sway of materialism, individualism became an effective factor in political and economic thought toward the end of the Middle Ages. The thought of its adherents became the ferment that led to the dissolution of inherited religious and moral systems and to the casting off of outlived cultures.[2] It is easy to understand why materialists would replace concepts of ideal and spiritual good and of abstract duty with appeals to the "natural," tending to mean by "natural" what seems to be materially necessary. They have thought most of the immediate material result, calling it utility or "goods"; and the greatest material good for the greatest number of atomic and nature-dominated individuals, has been their goal.

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[1] Cf. Bonar, *Philosophy and Political Economy*, chapters on Epicureans, Hobbes, Locke, etc. But, on the other hand, many phases of Socialism are based upon a similar philosophy, — though perhaps illogically so.

[2] Schmoller, *Grundriss der allgemeinen Volkswirtschaftslehre*, p. 71.

Naturally, materialism finds expression in ethics. No materialist could logically be content with the Golden Rule, as taught by Christ, as the basis for an ethical system. Rather we find the thoroughgoing materialist formulating his doctrine of right and wrong with an eye to the problems of adjustment to material environment, advocating that men do unto one another such things as will enable them to survive, and finding in "survival" the test of right.

The leaders in this school of philosophy have been such men as the Sophists and Epicureans in antiquity; Hobbes, Locke, and Rousseau, in early modern times; and Helvetius, the French Encyclopedists and Bentham, a little later. (Locke's philosophy was dualistic, but its predominant effect was to encourage materialistic developments in thought.) Aristotle, in maintaining that the sensible world must furnish the material for thought and that ideas come only through the senses; and John Stuart Mill, in his earlier thought, may also be said to show a materialistic tendency.

That a man's whole attitude toward Economics as a science is bound to be influenced by his philosophical leanings, whether these be conscious or not, may be easily demonstrated by pointing out the bearing of materialism and idealism upon the nature and scope of economic "laws." Idealism tends to make a thinker minimize the rule of scientific laws in economic life, or even to deny their existence. Witness the attitude in 1933 of the "New Dealers" and "Institutional Economists" in this country. They assumed certain ideals as to price levels and "social justice." They then proceeded without reference to normal equilibria between cost and utility, supply and demand, or exports and imports, to seek their goal by direct "social planning" and control. They would not wait for causes, in the shape of economic costs and utilities, to work their results, but instead "passed laws." They would not depend upon experience, but would experiment. Political values submerged or replaced economic values, as in war-time "emergencies." Thus these extreme idealists disregard or deny the validity of positive economic laws, for they do not recognize any "given conditions" as a base. They wish to make their own conditions by changing institutions — nothing is held to be normal but "social control."

Accordingly, economics to them would be a purely "normative" science, or rather, an art. It would become the means of attaining certain ideals set up by the "leaders." In place of scientific uniformities and cause-and-effect relationships, economics would deal with inducing or coercing individuals to act in conformity with some "plan."

All this is the extreme opposite to the attitude of the mere materialist, which was partially illustrated in the attitude of some of the English Classical economists in the early nineteenth century, with their iron law of wages and unqualified *laissez faire.* Few went to such extremes, but if they had done so, they would have treated costs and utilities as fixed and subject to no control. They would have made Economics not only a positive but also an absolute and rigid science, with individuals entirely subject to the coercive power of the "natural laws" of the material world.

One interesting implication of the preceding philosophical points of view is the attitude toward the future and progress. Idealism tends toward optimism; materialism tends toward pessimism. These tendencies are exemplified in the well-known pessimistic strain that is found in British materialism and the equally apparent optimism of continental writers having idealistic leanings — or, at least, being opposed to materialism. The logical connection between these two sets of philosophical tendencies is to be found in the fact that one's hopefulness of progress and reform is most easily associated with one's belief in the power of man to change conditions and to direct development. To be sure, one may rely upon the blind working of natural selection to bring about a future condition which one may "hope" will be better than the present. But, unless one assumes some ideal, and the existence of innate tendencies in man toward this ideal, — which means idealism, — one's hope must be relatively faint and conditional and could hardly be called optimism; and the present and the immediate future at least, may seem harsh and forbidding. Certainly thinkers, whether economists or not, who assume that the human mind can rise above the forces of material environment and who believe in the effectiveness of man-made institutions, can consistently assume an attitude toward the future that would be difficult for those of a more materialistic tendency.

This point is by no means simple, however, nor is the bearing of the philosophy upon the attitude of optimism or pessimism as essential as in some other cases. Thus the materialist may believe that "natural selection" will at least produce good leaders and bring them to the front; and he may be optimistic as to the ultimate results of economic life. On the other hand, the idealist may fear that social leaders may not be the best and that human institutions, despite their assumed potency, may actually fall far short of the ideal, in which case he may be pessimistic for the near future. In fact, much depends upon the period of time considered — upon how long the run. We find times when idealists pessimistically fear an immediate collapse unless their "plans" are followed, while materialists would await a "natural" readjustment with complete optimism.

Closely related to the contrast between pessimism and optimism, is that between the acceptance and non-acceptance of the doctrine of the indefinite expansibility of human wants, or of the indefinite sum of human satisfactions. Though few economists have set forth such fundamental premises as this, still it is apparent that the Classical economists assumed the truth of this doctrine, and that it — along with the principle of population — was essentially connected with their pessimism; for otherwise, in the face of diminishing returns, it would not be necessary to assume that production would be pushed to such lengths as they contemplated. (The concept of "divine discontent" is that of a materialist.) They could assume that exchange value would always measure utility and be the criterion of wealth, only on a doctrine which would insure that the intensity of desire for goods would be maintained at a point considerably above zero; for, beyond a certain point, the total supply of any good will decrease in exchange value while increasing in utility, and if desires were satisfied, goods, however useful, would not be "wealth." The materialistic cast of this doctrine is derived from the dependence of mind upon matter which it assumes: Human wants and satisfactions are thought of as having a "natural" tendency uncontrolled by judgments; and these unlimited human wants clash with a limited material environment, and must yield.

Idealists, on the other hand, conceive of judgments in control of physical facts — or at least independent of them — and accordingly do not accept the necessity of unlimited wants. Instead of extolling discontent, they seek more leisure for man. In fact, they are prone to have some ideal of what is "good for" man or is "needed" by him, with the corollary that beyond this he need not go in his consumption. To maintain this ideal the intervention of the state may be deemed desirable.

They are apt to assume some ideal as to a standard of living. When this is not attained, as in a business depression, they say that the trouble lies in "underconsumption," and seek to remedy the condition by a redistribution of income, shorter working hours at higher wage rates, and the like. This is illustrated by the thought of Socialists and of Sismondi.[1] Also it is manifest in the work of Malthus, who found difficulty in reconciling a materialistic law of population with an idealistic "moral restraint" upon procreation. Probably a fundamentally idealistic bent lies back of the belief that the trend of economic events can be directed by the manipulation of credit, as by the so-called "open market operations" of central banking systems.

An interesting corollary is the attitude toward overproduction: materialists, believing in unlimited expansion of wants, argue that overproduction is impossible. The idealistic tendency is to set some ideal limit to consumption and to call anything exceeding that limit overconsumption, and *vice versa.* Of this, one can find good illustrations in the writings of the French economist, Sismondi.

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[1] See below, pp. 395–396.

Value being the heart of Economics, the economist's philosophy is bound to shape his value theory. The age-long, fundamental antithesis between idealistic and materialistic tendencies in thought finds no clearer expression than one economist's statement that value may be defined as the measure of nature's power over man; utility as the measure of man's power over nature.[1] This thinker means that value in exchange is a function of the resistance offered by physical facts to the utilization of matter by man. That he is highly idealistic is apparent from the fact that he regards man as "acquiring dominion over nature." He believes that wealth consists in such dominion and that it increases with abundance. Consistent idealists are subjective in their theories of value, treating values as merely men's estimates of the importance of things for human purposes. The writer just mentioned refers to "the cause of the existence in the human mind of the idea of value, which is simply our estimate of the resistance to be overcome before we can enter upon the possession of the thing desired." Materialists, on the contrary, tend to formulate their definitions of value in objective terms, making value a quality of material things and defining it as power to exchange or quantity of goods commanded in exchange.

We find corresponding differences in theories concerning the determination and function of economic value. Idealists regard consumption as a means, making wants — or, as they are wont to say "needs" — a function of activity. Demand depends upon states of mind and judgments; nor are these mental facts mere reflexes of material necessity. Production, too, is desirable activity, and is to be regarded as an end by man, — a means of "self-expression." But consistent materialists consider consumption as the end of economic activity, and utility, or "goods," as the goal (utilitarianism). Accordingly, demand depends upon material things, and arises in states of consciousness that are induced by sensations that are caused by physical facts. Naturally materialists are most at home in discussing demand as limited to the needs of the material body — food, clothes, and shelter. Production is regarded as a means to the end, consumption; and cost is its salient characteristic. And the significance of cost is that it measures the dependence of man upon the material; wherefore, if value is determined by cost, and man's activities are determined by values, one must conclude that the material is dominant.

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[1] See below, p. 320.

It is all too common for economists to be inconsistent, and one need not be surprised to discover vicious mixtures of idealism and materialism. Thus we shall find one school reasoning as though material goods (utilities), as causes of sensations, determine values; and at the same time assuming that worth judgments (subjective values) sanction costs, i.e., the mind determines action without limitation by cost. And, again, we shall find another school arguing that material forces are inevitably driving us to a cataclysm from which we will be rescued by adopting a form of social organization known to the school!

It is even possible that, though some of the points taken as indices of philosophical tendency are more closely connected with the tendency indicated than others, a given thinker might hold views that ordinarily characterize opposing tendencies without inconsistency: for example, might not one be a pessimist and also believe in the natural inequality of men? Or may not both idealist and materialist find in "cost" the factor which determines economic value? There is also a sense in which "extremes meet," as in Individualism and Anarchism. Extreme scarcity and extreme abundance would both destroy economic values. But it is a fact that the two divergent lines of thought which we have been analyzing find expression in the two chains of ideas that are linked together or associated as here pointed out; and that, in their ordinary meaning — and considering their bearing upon economic life — they are logically so associated.

Again, one may well question whether the particular tendencies toward optimism and pessimism, cost or utility theory of value, and the like, are after all caused by the theorist's belief in any metaphysical doctrines. Certainly this question will often be answered in the negative if a conscious adherence to the school, accompanied by a realization of the full significance of its doctrines, is meant. But that is not the point. The materialistic tendency may be unrecognized by the writer in question and be inferred by the critic only as a result of searching analysis. Surely the tendencies above distinguished must affect all thought concerning human activity, for such activity is a function of judgment and physical fact, mind and matter, man and environment;[1] and a man's thought may be classed as surely on the basis of his conclusions concerning economic value as those concerning any other values.

It must not be thought that materialism and idealism are unrelated and independent of one another, nor that either can be taken alone as containing the truth. These two philosophical tendencies represent two sides of human social life, and they constantly react upon one another. They are indicative of what has always been the most fundamental contrast in economic thought, that between "man," regarded as an independent element separate from his natural environment, and "nature." And, like man and "land," mind and matter may be truly regarded as interrelated and reacting upon one another. Thus, when we say that idealism is related to the institution, considered as embodying a human ideal, and is conservative, we must remember that reasonable idealists do not uphold the letter, but the spirit of the institution; and thus, under changing conditions, material factors enter — through the door of realism — or the institution loses its efficiency. The outside is let in. It must be let in to preserve the institution. On the other hand, materialism, in opposing institutions and denying man's power to dictate terms to nature, must not be thought of as merely negative and unrelated. Human institutions become realities and react upon the men who "created" them. The negative is always related to the positive. Individualism does not necessarily mean non-organization. In their relation to one another, the two philosophies are analogous to man and "nature," heredity and environment; and each reacts upon the other in a similar fashion.

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[1] This is true even if these dualisms be regarded as unreal, and the two members as really one.

In criticism of the two philosophical tendencies, taken separately, it may be said that neither solves the problem of the relation between mind and matter, man and physical environment; for to deny the independent existence of the one or the other is no answer.

More particularly, the materialist, as a result of his attempt to reduce everything to terms of matter or physical fact, tends to take too narrow a view of mental and moral forces, and the initiative and power of man's mind; while idealists underestimate the importance of physical facts as limiting and directing the action of the mind. The former are prone to overvalue reason regarded as a sort of mechanical combination of sensations based on physical facts; while the latter are equally prone to set up ideal postulates which run counter to experience.

The idealist finds great difficulty in answering the question, Are there not as many worlds as there are individual minds? The persistent unities in the external world of experience seem to refute his thought. At the same time, he has no adequate explanation of the differences among man. In his economic thought, he seeks a basis for uniformities and orderly sequences by setting up some super-individual mind — either God, or some idolized dictator, or an abstract "social mind." But this does not bridge the gaps among individual minds, nor the gap between the individual and society. Coercion of individuals necessarily results. On the other hand, the materialist does not know how to explain either the persistent divergences and evolutions in the external world, or the differences among men (despite their "common clay"), particularly in their ideas. He is driven to fall back upon some metaphysical "natural order" which is to be known only by the test of survival. The individual is left to the mercy of other individuals, which is but a negative freedom, and leads to that form of tyranny known as the "equal treatment of unequals."

Of special interest to students of social science are the criticisms based on false notions of society and the relation between society and individuals.[1] On this score consistent materialists lay themselves open to the charge of undervaluing the force of society, an attitude logically associated with a disbelief in the potency of social institutions. Consequently their influence operates unduly to restrict the field of collective social action. Idealists, on the other hand, go to the other extreme. By conceiving of the individual (his mind) as subordinate to other individual and mental and spiritual forces, they frequently argue as though the individual exists for the sake of society.

Every thinker, economist or not, must at some time or other, put questions to himself which amount to asking: Are you tending toward idealism or toward materialism? What is the significance of your point of view as to the relation, existing and potential, between mind and matter, human reason and physical environment? Or, if the attempt is made to attain the truest point of view of all by bringing to a synthesis the elements of truth in idealism and materialism, the question always remains, where shall the line be drawn? This approach leads to Dualism, Monism, or Agnosticism.

To the author, Dualism seems to afford the wisest working hypothesis for the philosophy of a social scientist. At the least, it enables him to avoid the error of absolutism. And it frees him from the extremes of naturalism and individualism, as well as from "institutionalism" and Socialism. It seems that an empirical approach must serve, until the issue between sensationalism and rationalism is settled, and that thus far in the development of human thought, Liberalism and a *broadly interpreted* Utilitarianism have been most conducive to understanding.

2. Method. — Broadly speaking, the history of science in general reveals the use of two distinct methods, two processes by which truth is sought. These are commonly called inductive and deductive. There is a method which is neither inductive nor deductive in the technical sense of the terms, and which may be called the statistical method.[1] This last, however, is, in the final analysis, a combination of the first two.

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[1] See Haney, L. H., "The Social Point of View in Economics," *Quarterly Journal of Economics*, Sept. and Nov., 1913.

In fact, one can scarcely follow either method to the absolute exclusion of the other, for they are complementary. Yet with some economists, deduction so predominates that their method is called deductive, and *vice versa.* Most thinkers, through some natural bent of mind, seem to follow one method more readily than the other.

The deductive, or "isolating," method is that which works from the general to the particular by mental processes of analysis. In its practice, a knowledge of the forces or conditions affecting a problem is assumed, and the results are inferred according to certain logical principles; though, when most effectively used, observations are made to test the validity of the assumptions as to forces and conditions and to verify the conclusions reached. This method sometimes leads a thinker to look within himself for his premises and to draw upon the concepts and judgments of his mind. Sometimes such thinkers maintain that sufficient premises can be drawn from "common experience," or "familiar facts," and then they are apt to depend upon abstract, unverified "natural tendencies." Thus Richard Whately, Archbishop of Dublin, argued that Political

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[1] Schönberg, *Handbuch d. Pol. Ök.*, 3 Band 2, p. 206, art. by Rümelin. Also, Oncken, *Geschichte der National Ökonomie*, p. 9, distinguishes (1) "die exacte oder philosophische, (2) die historische oder besser historisch-statistische, und endlich (3) die historisch-philosophische, 'welche einen synthetischen Character besitzt.'" Quesnay, Ricardo, von Thünen, Jevons, etc., pursued the first; the Mercantilists, Muller, List, Hildebrand, etc., followed the second; Aristotle, Smith, Marx, and Kant illustrate the last. Rümelin in the able discussion of this point just referred to properly distinguishes between the inductive and the statistical methods, on the ground that the former deals with classes or kinds of which one thing or case can be taken as typical and made the basis for induction, whereas in statistics as a method pluralities are dealt with which have some distinguishing character in common, but may differ more or less as to other features. This makes analysis necessary. Thus we may oppose the statistical method to the inductive or to the deductive method taken alone. It seems, however, that the difference lies in the fact that the statistical method combines *both*, only thus making a peculiar method.

Economy needed no collection of facts.[1] And when, some years ago, an attempt was made to organize a society for the study of economic phenomena in an American city, the organizer was constrained to write, "The opinion prevails far too widely that political economists must be mere doctrinaires, and must contend for some set of opinions and some course of policy. Critical study of phenomena is as unpopular as free thinking in religion."[2]

It is this extreme type of deductive method that gives rise to what the German economist, Knies, has called absolutism of theory. God and the mind are unchangeable, sometimes runs the argument, hence deductions drawn from the nature of God and of the mind are of the same absolute character. If drawn by correct processes they are good for all times (perpetualism) and for all places (cosmopolitanism). "Political economy," said an English economist of a former generation,[3] "belongs to no nation; it is of no country; it is founded on the attributes of the human mind, and no power can change it." And it was a similar spirit that led a more noted English economist, Torrens, to state that the period of doubt and controversy was passing away, so that within a generation all men might be expected to believe alike in economic theory.[4]

Of course, such conclusions are extreme, and represent an abuse of method, the trouble lying in the over-abstract character of the premises and the absence of verification of results; but they serve to point the lesson that pure deduction is, in economics at least, so dangerous that its employment may be regarded with something akin to suspicion. Striking instances will appear in the thought of economists to be treated in these pages.

There have been many revolts against this method of thought. Socrates [5] and Bacon led such revolts in their days. About the middle of the last century, too, there arose a veritable insurrection led by thinkers of the so-called Historical School. These men, most numerous in Germany, stood for the inductive method, that is, the method that works from the particular to the general and leads a thinker to look outside himself to the external world for facts to serve as the basis of empirical laws. This may be called the method of observation. The Historical School, as will be seen more in detail, denied that economic doctrines, especially if looking toward application as industrial policies, are good for all times and all places. Human nature itself, they urged, is not unchangeable. The assumption of deductive economists that men are guided in their economic activities by self-interest, they refused to adopt as a premise until it had been established inductively by observation of the phenomena of actual life and of the manifestations of human motives. Also, they insisted that such conclusions as that free trade and division of labor are advantageous or that wages and interest tend to become equalized among different industries, are questionable, and can be established only by the collection of many particular cases drawn from different places and times.

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[1] *Political Economy*, IX, pp. 148–150.

[2] Professor Folwell, Johns Hopkins University Studies, Vol. VI, p. 7.

[3] Lowe (Robert), "Recent Attacks on Political Economy," *Nineteenth Century*, November, 1878.

[4] *Essay on Production of Wealth*, 1821.

[5] True, Socrates told man to study himself. But in his day that was a step in the direction of the concrete and inductive. The apparatus and method for the

Here, too, we find extreme types, — types which, instead of excessive use of abstraction, become lost in concrete cases, and become so interested in verification that they discover little of principle. Though serving as a valuable corrective to the abstract dogmatism of the Classical economists, the thought of those economists who come nearest to using pure induction, by its barrenness of generalization, shows the danger of a one-sided use of the method of observation.

As will appear further on, there has been much debate, especially in Germany, over the relative merits of the two methods; though few, if any, now deny that each has its place. In fact,

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study of nature were not developed, and the abstract speculation of his time was largely concerned with the actual physical universe, etc. It was in Bacon's spirit, then, that Socrates urged observation in study of man. Induction works out from the observation of special individual cases to the general rule or "law" which explains and which may serve as a basis for deductions. Socrates himself was both deductive and inductive. He objected merely to the exclusive and abstract use of deduction.

the disputes seem generally to have been based upon differences in judgment as to the scope or the completeness of economics.

Those writers who make economics deal chiefly with such subjects as theory of value and money — especially if inclined to regard the science as nearly complete — make large use of deduction. And logically so. When the economist deliberately abstracts reflective choices among utilities from emotional wants, or separates in his thought individual desires to consume or possess goods from ethical or political considerations, he may reach abstractly valid conclusions, and such conclusions may even have practical value. In dealing with such a question as the incidence of taxation, for example, observation and induction would, until very recent times, at least, have been relatively powerless; and the same may be said of the determination of the "shares" in distribution.

When, however, economics has been regarded as having a very broad field, especially if including practical political and ethical considerations; or when it is taken to be an applied science, there is apt to be a feeling that abstraction must leave out so much that it will become over-heroic. It is quite true, moreover, that in dealing with such subjects as poor laws and tariff protection observation and even experimentation are practicable. Also, there is less likelihood that the science so considered could be regarded as complete; consequently the tendency is to depend upon induction to establish new premises or to verify old ones. More facts are called for, and history and statistics are the natural recourse.

In short, (1) if a thinker regards his science as complete, he tends to be deductive; and *vice versa.* And (2) if he narrows its scope, by abstraction or otherwise, he produces a kind of simplicity which encourages deduction; and *vice versa.* (But that kind of "simplification" which seeks to unify all human motives and sanctions in a "sociology" or a "natural order," is apt either to rely upon tremendous underlying deductions, or to be devoid of any scientific uniformities whatever.) Finally, (3) if one considers Economics as a positive science based upon the assumption of "existing conditions," one may go further in drawing deductive conclusions than if one considers it a normative discipline, and seeks to control human activities. (In the latter case, however, one must have a "plan," and that involves a great preliminary deduction and its use as a major premise!)

As one looks back over the course of economic thought and examines its changing methods, one is reminded of attempts that have been made to distinguish certain stages in the evolution of human thought in general, notably the three stages of Comte. These stages were called by Comte [1] the theological, the metaphysical, and the positive. In the first stage men seek a "cause" for phenomena, and find it to lie in the immediate action of supernatural beings. In the second, one great entity, "nature," is substituted as the cause, and the phenomena are said to be due to abstract "essences" or forces within the objects, but separate from them: sleep is caused by a "soporific principle"; water rises in the tube because "nature abhors a vacuum." In the positive stage, men classify phenomena and establish sequences in the nature of cause and effect; they discover quantitative relations and seek to represent all phenomena as aspects of a single general fact. During the theological and metaphysical stages, the deductive method is predominant. Early investigators may be regarded as overwhelmed by a multiplicity of facts, to gather together and classify which required time. Meanwhile it was necessary to regard each fact as more or less isolated — which left the mind's desire for unity unsatisfied, — or seek an explanation from within the thinker's own consciousness. The result was the dogma that it is God's will, or some metaphysical law of "nature." Those who thus traced all phenomena to a few easily grasped "causes" bore everything before them.[2]

The triumph of such abstract deductive methods was only temporary. Becoming weary of empty speculations, as their slight foundations were perceived, men turned to follow those who confined their attention to the knowable and attempted to explain that by more rational and concrete methods. Thus there came about a condition similar to Comte's positive stage.

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[1] *Positive Philosophy*, Chap. 1; Martineau's translation, p. 26.

[2] Cf. Hobhouse on "Comte's Three Stages" in the *Sociological Review* for July, 1908.

It is, however, improper to speak of these methods as stages in the sense of their following one another in chronological order; for they overlap, and cases may be found of the contemporaneous existence of all the stages, even in the field of a single science. There are "theological" economists today, perhaps, and certainly there are economists whose mode of thought places them in the metaphysical stage. An extreme illustration will serve to make the meaning clear. The American economist, Henry C. Carey, in speaking of the Malthusian theory of population, asks how a good God could allow such things as it teaches. He declares the doctrine incompatible with God's character; therefore it is untrue. Of course he does not stop here in his argumentation, but the point is that he introduces this reasoning as an essential support for his ideas. Political economists of the metaphysical type, a type preëminently English, tend to deduce all economic phenomena from so-called fundamental principles of human nature, axioms, and arbitrary definitions. Their earmark is a certain use of the word "natural." Glib explanations that this or that is according to a law of nature or that human nature is thus and so, are the danger signals. The legal thought of the past generation is a notable lingering place of this taint; and those economists who argue about "natural rates" (for wages, railway charges, etc.) maintaining that competition is natural, for instance, show a similar tendency. As already stated, the method of thought of such men is necessarily deductive.

It remains to be observed that cycles in method seem to have existed. The deductive or philosophical-abstract method prevailed in all early economic thought of a formal character that has been recorded. Then the Mercantilists and the Kameralists of the sixteenth and seventeenth centuries showed some tendency toward an inductive, though rather empirical, method.

But the early French economists and Adam Smith were primarily deductive, and the "Epigones" who followed degenerated into dogmatism. The early historical economists then arose as an inductive school, perhaps even going to extremes; and, after a generation given to the collection and comparison of facts, the need for deduction became effective. The Austrian school of economists and Professor Marshall, in England, then came to the front; but their method is not that of the older deductionists, being based upon the preceding era of induction and largely free from theological and, to a less extent, from metaphysical tendencies. The cycle has not been a circle, but a spiral, rising to higher planes.

At the present time economists are largely engaged in concrete investigations, historical and statistical; but numerous treatises are appearing, indicating the concomitant and scientific use of both methods. Induction and deduction, the concrete and the abstract, must go hand in hand.

CHAPTER II

THE ORIGIN AND TARDY DEVELOPMENT OF ECONOMIC THOUGHT

The origin of economic thought is lost in the past. In its simplest form it must have always existed wherever thinking beings sought to gain a living. Economic ideas of any definiteness find their earliest expression, however, in rules of conduct or moral codes formulated by priests or lawgivers. These moral codes, like the Mosaic law, for example, in dealing with man's place in the world, with life and death, and the ends of existence,[1] necessarily touched upon economic matters. If it be said that custom ruled the early civilizations and that these codes were the expression of custom, the same conclusion holds. The philosophy underlying was broad and simple, and economic concepts were presented with those of ethics and religion as one whole.

Not until group life began to move in the new and complicated ways of money economy did economic ideas begin to become sharply differentiated. It was when problems of colonies, international trade, money, taxation, etc., arose, that the Greeks began to discuss economic questions.

The reasons for the tardy development of important economic ideas among the ancients are significant, for they throw light upon the origin of the science and the factors essential to its growth. These reasons fall into two great classes, being partly subjective, partly objective, — though the close interrelation between them is noteworthy.

Among the subjective or psychological causes, perhaps the first to be noted is the tendency of the ancient thinkers to look down upon wants for material things. Material pleasures and the gratification of bodily desires were frequently frowned upon.

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[1] Schmoller, *Grundriss der allgemeinen Volkswirtschaftslehre*, s. 69 ff.

Socrates thought that to have few wants was god-like, and that was the spirit of the Hindu philosophy. Where such an attitude prevails, the development of a science which deals with the means of gratifying wants is difficult. It implies a disregard for the material.

In association with this disregard for material considerations it was characteristic of ancient thought concerning social matters that a dominant place was given to the moral sanction. Then, as now, ethical and economic ideas were closely interrelated. Today, however, we consciously separate the two, and often recognize economic considerations as the controlling factor, sometimes calling that right which is deemed to be conducive to material advantage and the gratification of our expanding wants. The ancient thinkers were less prone to take their wants seriously, as ultimate considerations, and sought happiness through the "good" life rather than the full life.[1] They thought happiness could be reached more directly, as it were, without the elaboration of that mass of means which we call wealth.

This fact was no doubt partly due to the prevalence of absolute authority, either in the shape of family, tribal, royal, or priestly heads, whose "thou shalt" was law, or in the shape of custom. Custom was a paramount force limiting choice and competition, and tending to conceal the importance of economic motives.

In short, there was more speculation about morals than about economic life. Ancient philosophy in its social aspects was simple, the political, economic and ethical values being little differentiated, and under the circumstances the whole was pervaded by a moral tone.

Part and parcel of the subjective attitude of ancient economic thought is the fact that some of the interests most conducive to economic study were especially deprecated. One of the most fruitful sources of economic speculation has been the earnest desire to better the condition of the laboring classes. But, in general, pagan philosophy taught that industry, except, perhaps, in agriculture, is degrading to body and intellect. Slavery was common. Artisans belonged to the lowest "caste." During the greater part of their history the Greeks and Romans despised the laboring and trading classes. Aristotle, for example, argues that in the best government, where the citizens are all virtuous and happy, "none of them should be permitted to exercise any low mechanical employment or traffic, as being ignoble and destructive to virtue";[1] and Plato, in treating of the ideal state, deems it not worth while to concern himself with the trading and artisan classes. The above quotation from Aristotle goes on to say that those destined for public office should not even be husbandmen, for leisure is necessary to improve in virtue and fulfill one's duty to the state. This suggests that his disapproval of labor arises in part from other grounds than its inherent baseness, namely, from his belief in the expediency of leisure. (This side of the philosophers' attitude toward labor has often been overlooked.)

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[1] E.g., the "full dinner pail," "a chicken in every pot," "a more abundant life," etc.

When it is remembered to what an extent the development of political economy has gone hand in hand with a recognition of the importance of labor, the significance of the preceding ideas appears. Adam Smith ascribes to labor so much, that the Socialists profess to have learned from the *Wealth of Nations* to attribute all value to labor, and to demand for labor the entire product of industry.

The same general point concerning indifference or aversion to economic phenomena might be made with regard to financial matters, though with some exceptions.

The omnipotence of the state in antiquity and the ascendancy of purely political interests were other factors retarding the development of economic thought. Where political speculation, as such, absorbs the attention of thinkers, economics remains in a subordinate place. While the mere fact of the dominance of the state and absence of individualism does not seem necessarily to preclude a sort of Social Economics, it does limit the field for the objective expression of individual valuations, and tends to subject economic considerations to political.[1] Certainly Economics did not come into existence as a science until the importance of the individual had been realized in a way different from what it ever was in antiquity.

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[1] *Politics*, VII, iv.

So far as it was the idea of the ancients to gain wealth by conquest and forced labor, another subjective force working against the evolution of economic thought may be distinguished. This idea — and it played no small part in ancient civilizations — is not in harmony with the aim of political economy, which seeks the laws governing wealth that is gained by domestic production and by the peaceful exchange of domestic products for foreign goods.

Finally, among subjective reasons, must be mentioned that tendency in men which leads them first to busy themselves with the remote. That "familiarity breeds contempt," while "distance lends enchantment," is true in the evolution of science. As Sir Henry Sumner Maine remarks, in discussing family types in certain countries, "natural families have not been as carefully examined as could be wished; they have not the strangeness of the house community in the eyes of the observers." [2] Wonder and surprise are effective causes for interest and study.[3] Remote and mysterious things arouse our curiosity, leading to hazardous mountain climbing and quests for the north pole. So astronomy was the first of the natural sciences, and to this day many men by their gifts for astronomical research illustrate the same attitude. Economic phenomena, especially in the days of relatively static and simple economic life, were slow in arousing interest. Because of their nearness and the general superficial familiarity with them, they were not singled out for special study.

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[1] The distinction between those factors which prevented or retarded and those which merely modified or determined is to be observed. The same factor may have both kinds of effect. The modifying, directive aspects of these and other factors will be discussed below.

[2] *Early Law and Custom,* Vol. VIII, p. 243.

[3] Adam Smith discusses this general idea in his essay on "The Principles which lead and direct Philosophical Enquiries, Illustrated by the History of Astronomy." (*Works,* Vol. V, pp. 55, 88.)

From the *objective* point of view, economic thought was hampered in two general ways: the phenomena were lacking, while attention was called from such economic phenomena as there were, and directed to other fields. To put it in another way, economic phenomena were deficient in number and in weight, that is, absolutely and relatively.

Early civilizations generally flourished in warm and well-watered regions where it was not difficult for a relatively sparse population to get a living. The thinkers of such civilizations ordinarily belonged to or were dependent upon a dominant class supported by a servile population. Under such circumstances, the problems arising out of scarcity and labor and abstinence were given scant attention. Economic values required little study.

The subject matter of Economics, as a social science, is human relations. So far as the production and distribution of wealth are directly involved, it deals with relations among individuals, among households, among states, and the reciprocal relations which in turn arise among these various units. This great complex of relations did not exist in the past to anything like the same extent that it now does. Especially simple were the relations between states, and those between individual and state.

More concretely, division of labor was not carried very far. An independent domestic economy means a large degree of economic isolation, and this characterizes the states of antiquity. Only with the growth of division of labor and exchange could economic relations grow in number and significance, and develop that volume, complexity, and intensity which are required to stimulate economic thought.

Still more concretely, the problems of public finance were relatively unimportant. The revenues and expenditures of the ancient Grecian states, for example, were comparatively insignificant. When the Peloponnesian War began, the entire revenue of Athens amounted to about 1000 talents, or a little over $1,000,000.[1] This would be but a bagatelle in the budget of a modern state. The French budget for 1909 estimated the revenue of the state at 3,973,265,048 francs, say $790,000,000, and the expenditure at 3,973,035,678 francs. The total estimated ordinary receipts of the United States were similar, while by 1929 these had risen to exceed $4,000,000,000. The financial operations of Rome were, of course, much larger than those of the Grecian states, but they were far less complicated than ours. War was in general self-supporting, and even yielded a revenue in the shape of booty and tribute. Public debts like those of the modern nation were undreamed of, and such taxes as existed were "farmed" out to be collected by private contractors. When one recalls the important part public finance has played in economic thought, as seen in the careers of Sully and Colbert, for instance, and in the United States after the Civil War, one realizes that a great stimulus was lacking.

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[1] Blanqui, *History of Political Economy*, p. 13. Taken from Grote, Vol. VI, p. 10.

Or consider foreign trade. International commerce gives rise to many interesting questions of political economy, but it was not encouraged by ancient states, whose ideal was national exclusion. Sparta was such a state; and Plato's ideal states, even the second best, limited intercourse with foreigners, the *barbaroi*.

The objective factors, which, by attracting men's attention and energies, threw into the background the consideration of such economic phenomena as existed, also embraced certain social institutions and customs, i.e., subjective factors that had become crystallized. Practical politics, war, religious activities, filled a large part of men's lives. The relative lack of security both for life and property which characterizes ancient times was also an important factor in retarding saving, exchange, and economic activities in general.

Thus, the phenomena being rudimentary, and the spirit or mental attitude indifferent or hostile, it is little wonder that the peoples of antiquity not only did not evolve a body of economic doctrine, but even showed a paucity of economic ideas.

In what has gone before, reference has been made to the ancients alone. Much that has been said, however, is applicable to peoples of later times. Although it was formally quite different, during the period of the Middle Ages, as will appear in the chapter dealing with that period, the situation was not dissimilar, whether regarded subjectively or objectively. On the one hand, the teachings of the Church were hostile to trade; on the other, division of labor and exchange were undeveloped, and man's energies were occupied in reconstructing political institutions and in developing the arts.

Then came the era of Reformation and Renaissance. The attitude of men toward the world and material things was changed, while economic relations were multiplied by discoveries and inventions and the extended use of money. More and more men thought economic thoughts, and erelong the science of Political Economy was born.

B. ECONOMIC THOUGHT BEFORE THE SCIENCE OF ECONOMICS

I. ECONOMIC THOUGHT OF THE ANCIENTS

In the chapters which follow next, it is not intended to convey the idea that a science of Economics existed prior to the eighteenth century. Quite the reverse. These chapters are to deal with fragmentary economic thoughts, or with economic thoughts which are found embedded in ethical and religious systems. Yet these thoughts are the stuff of which the later economic theories were partly made; and, although from the point of view of economics they hail from a pre-scientific period, their importance as a factor in determining the course of the science may not safely be overlooked. Accordingly, the reader is asked to direct his attention to the following sketch and brief analysis of the economic ideas which obtained in the ancient and medieval worlds.

Even if the present work were limited to the history of Economics as a science, it could not well omit some discussion of the origin of the science. At the very least, one must understand "Mercantilism" if one is to understand the Classical Economics of Adam Smith and his followers. But no thorough understanding of Mercantilism is possible without knowing something of the medieval conditions and thought which preceded it.

To suggest a few illustrations: The ideas of the ancients concerning wealth and wants have ever stimulated idealistic thoughts among economists living in periods more given to materialism: such ideas may be traced in the history of Socialism, and as "nature philosophy," have affected all social thought. Even today, one can scarcely discuss interest in any extended way without going back to the Bible and to Greek notions. How could the Classical political economy of England be understood without a knowledge of the Mercantilist period, including such men as Locke and Petty? And an understanding of these men takes one back to the medieval period, which period, roughly speaking, is half ancient. Kameralism has been the mother of modern German economic thought, and Kameralism was in large part the offspring of ancient ideas and notably those embodied in the *Corpus Juris Civilis.*

CHAPTER III

ORIENTAL ECONOMIC THOUGHT, ESPECIALLY THE CONCEPTS OF THE HEBREWS AND HINDUS[1]

Some general points of contrast may doubtless be found in comparing the economic thought of the Orient with that of the Occident. For example, within certain racial or national bounds, nearly all Oriental peoples will be found to have had ideals of a closer brotherhood than have obtained in western countries. Eastern peoples, too, have generally tended to a less materialistic view of life, not striving eagerly for industrial progress: moral or religious codes have usually played a greater part in shaping their thought.

Much of the contrast that has been drawn, however, would not have held for the remote past when the civilization of the West was young, and both Orient and Occident were in something like Comte's theological stage; while so diverse are the numerous peoples which come under the head of Orientals that truly general contrasts are very few, and are for the most part so broad as to lack force and precision. Believing, then, that it is quite impossible to generalize with any great significance concerning Oriental economic ideas as a whole, the author proposes simply to state what is known about such ideas as they were held by the Semitic and Aryan peoples of the west and south of Asia. To lump Chinese, Medes and Persians, Jews, Japanese, Arabs, Hindus, even Egyptians, together in one topic, as is sometimes done,[2] is misleading, to say the least; but those concepts of the Hebrews and of the Hindus which have clear economic significance may be briefly stated. Then, if there be any common ground, some precise generalization may follow.

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[1] Cf. Cooke, "Old Testament Economics," in *Economic Review*, XIX, no. 4; Marigny, *Histoire de l'économie politique des anciens peuples;* Michaelis, *Commentaries on the Laws of Moses* (Eng. trans., London, 1814); *Jewish Encyclopedia*, articles on agriculture, usury, etc.; and the following footnote references.

[2] E.g., Cossa, *Introduction to the Study of Political Economy;* Ingram, *History of Political Economy.*

It may be observed in advance that the subject matter furnished by the ideas of these two peoples has this much in common: it is the economic thought of two south-Asiatic peoples, both of ancient civilization, and based upon an agricultural economy; and practically all is drawn from the writings of priestly lawgivers.

It follows from this latter fact that any idealistic tendencies will be emphasized, perhaps to such an extent that doubt may be felt as to how truly the common thought is expressed. But when one reflects that the lives of these people were largely determined by these writings, this doubt loses some importance. And above all, it is just these writings which have come down to us, exerting a powerful influence all through the Middle Ages and even to our own time; so that, *from the standpoint of the history of economic thought*, their significance is not slight.

Several more or less practical reasons make this particular inquiry worth while. For one thing, there is its value as a study of origins. These peoples were, in a sense, in the childhood of civilization; and, just as psychologists are interested in child psychology, economists may learn lessons from child economics. Or, if it be true, as many believe, that there is a large degree of connectedness in the development of the economic thought of the world, — a degree not generally realized to the full, — the study of early sources gains importance; and, if it is found that at the sources religious or moral sanctions dominate, then a study of the economic aspects of religious or moral concepts and codes is required.

While there is no logical necessity for treating Oriental ideas as a whole, as do some writers,[1] it is essential to analyze the thought of the Hebrews in this respect. No one will deny that many of our religious and moral beliefs are traceable directly to Hebrew thought, and that these beliefs have in the past had, and will in the future have, considerable influence over economic ideas. A large part of these have come down to us through Christianity, which in its origin is an essentially Oriental religion.

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[1] E.g., Kautz, *Geschichtliche Entwickelung d. National Oekonomie.*

This study, too, will illustrate and emphasize the importance of the relationship between economic thought and morals and ethics, a relationship which, without being confused, needs to be borne in mind by the economist.

And of some practical significance is the fact that light may be thrown upon economic concepts which to some extent obtain in the Orient even to this day.

Economic Thought Expressed in Rules of Conduct, Law, etc. — As has been said more than once, the central idea of Hebrew government and education was the fulfillment of the law, the commands of Moses or the prophets forming the standard in all thought and action,[1] and the situation was quite similar among the Hindus. Now such a situation meant a minute regulation of everyday life,[2] its economic aspects included, and it follows that the material for this study is mostly drawn from rules of conduct or laws. A study of those regulations of the Hebrews and Hindus which are significant as indicating the character of their economic thought shows that the following subjects were the most important: occupations, agriculture, interest and usury, labor and wages, property rights, taxation, inheritance, weights and measures, adulteration, monopoly, and the poor. All of these topics cannot be treated here, but only those about which the regulation was considerable and of clear intent.

Usury. — The Mosaic law forbade lending "upon usury," that is, at interest; it prohibited "usury of money, usury of victuals, usury of anything that is lent upon usury." [3] This applied only to fellow Hebrews, however, loans on usury to strangers being allowable. Mercy in case of loans to the poor [1] was enjoined. Some evidence of development in the law of usury exists, for, in the first pronouncement, interest-taking was forbidden in the case of loans to the poor alone (*Ex.* xxii, 25); [2] but later — perhaps because of fraud — the prohibition was extended to all Israelites. The exception of strangers must have made loans at interest possible by using such persons as intermediaries. When, in post-exilic days, trade increased and with it loans of capital, the Rabbis made further modifications.[3]

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[1] Conder, *Judas Maccabæus*, p. 24.

[2] Among the Jews the prophets, however, were generally opposed to such a regulatory spirit, tending to ignore the regulations. See, e.g., *Amos* vii, 10 ff.; *Hosea* vi, 6; *Isaiah* i, 10–17.

[3] *Deut.* xxiii, 19, 20.

Two kinds of loans were distinguished by Mosaic law: "Thou shalt not give him (1) thy money upon usury, nor lend him (2) thy victuals for increase" [4] (*Lev.* xxv, 37). Neither is to be thought of as connoting all that the term "interest" does, as used in economics, for they involve no concept of capital, and but an imperfect one of value. The Mosaic "usurer" was merely one who lent things for considerable periods of time, receiving three shekels where he had given two, or three bushels for two.

In fact, the law seems to have desired that lending should be regarded as a form of charity, ordaining that the poor be given loans even though the seventh year, when debts should lapse, were at hand, or though no security were given (*Deut.* xv, 7–9; xxiv, 13). It must be remembered that such regulation went hand in hand with legislation which aimed to prevent the alienation of property, and that the seventh and jubilee years, if enforced, would have put lending on a very different basis from what is usual.

But the Mosaic law was not maintained in force without modification. The jubilee year was not enforced, and commercial dealings grew. Solomon appears to have been engaged in much trading, and after the return from Babylon, where commercial transactions of many kinds were highly developed, including lending at interest, the Hebrews parted more from the spirit of the old laws. The word meaning "per cent" does not seem to have been used until after the captivity, the idea of interest as a *rate* being found in Nehemiah for the first time; here the prophet exhorted the usurers to restore "the hundredth part of the money, and of the corn, the wine, and the oil, that ye exact of them" (v, 11). An attempt was made to keep the letter of the law, however, and its importance to an understanding of medieval doctrines is well known.

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[1] *Deut.* xxiv, 10–14.

[2] Cf. Driver, *Introduction to the Literature of the Old Testament*, pp. 35 f.

[3] *Jewish Encyclopedia*, article on "Usury."

[4] No essential difference in treatment appears in the law; but the word "increase," indicating that which was forbidden in the second kind of loan, is different from the one translated as "usury," and this might indicate a different attitude toward the former, as being more liable to fluctuations in value and bulk.

The security for loans, above referred to, was in the nature of a "pledge," and there was some regulation concerning such pledges. One rule might be formulated thus: Thou shalt not demand as a pledge any of thy brother's necessities. For a man's upper garment must be returned before nightfall, and "no man shall take the nether or the upper millstone to pledge: for he taketh a man's life to pledge" (*Deut.* xxiv, 6). Another rule was that one must not go into the borrower's house and take his pledge, but must let him bring it out; and if the borrower were a poor man his pledge should be returned before the night (*Deut.* xxiv, 10–13). In the book of Job men are upbraided for taking the widow's ox as a pledge, and for taking pledges when no corresponding loans had been made (chaps. xxii, xxiv).

Among the most striking regulations of the Brahmanic law were those concerning interest and usury. Money-lending by the higher castes was closely restricted. Brahmanas and Kshatriyas could not lend anything at interest, acting like usurers, except to exceedingly wicked persons who neglected their sacred duties.[1] "Now they quote also (the following verses): 'He who acquiring property cheap, gives it for a high price, is called a usurer and blamed among those who recite the Veda.' "[2] In case of loans made without security the following terms were legal: for gold, double value (i.e., 100 per cent); for grain, treble the original price; anything sold by weight might be lent at eight times the original value.[3] On security, the following law obtained: " 'Hear the interest for a money lender declared by the words of Vasishtha, 5 mashas for twenty (Karsha-panas may be taken every month): thus the law is not violated.' " This meant about 15 per cent per annum. By another provision, 2, 3, 4, and 5 per cent might be taken from the four castes respectively. There was difference of opinion as to a limit for aggregate interest payments, some holding that, in some cases at least, interest should only be paid for one year, others that interest should cease after the principal had been doubled. In any case, "the King's death shall stop the interest on money (lent); and after the coronation of (a new) King the capital grows again," — illustrating the dominance of political considerations.

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[1] *Vasishtha*, II, 40 ff. [2] *Ibid.* [3] *Ibid.*, 47.

Various kinds of interest payment were distinguished: there might be compound, periodical, stipulated, corporal, daily, and use of pledge,[1] — corporal interest being that paid in labor, use of pledge referring to cases in which the lender made use of some security, such as a beast of burden.

Thus the fact is apparent that among the ancient Hindus interest was closely connected with some concept of a just price; that the rate varied with the caste, and that a wicked man might be bled where another might not be; that the rate varied with the thing lent, loans of money and staple commodities like grain bearing a lower rate than others; and that there was some maximum limit for aggregate interest payment.

One striking similarity between the ideas of Hebrew and Hindu on the foregoing subject must have been noticed, namely, the notion that there should be some maximum for interest payment. At the death of the king or the jubilee year or the doubling of the principal, interest should cease. Both peoples dreamed of the establishment of a *tabula rasa*, when, to a greater or less extent, debtor and creditor should be equalized. It will be observed, too, that both peoples drew distinctions between borrowers: money or other things might be lent at usury, here to the "stranger," there to the "exceedingly wicked person" or to the lower caste.

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[1] *Sacred Books of the East*, Max Müller, editor, Vol. II, p. 239; *Gautama*, XII, 30–35.

Commercial Regulations and Just Price. — That some progress was made in reasoning about commercial matters is evidenced by a set of measures directed toward securing justice in buying and selling. Both Hebrews and Hindus had careful regulations against false weights and measures,[1] and against adulteration. Provisions against speculation, monopoly, and the like were even more significant. Raising market prices by speculative means was disapproved of by Rabbinical law, being classed with usury and false weights, and middlemen were not tolerated. The export of necessary articles of food was forbidden, and in time of famine no storing was allowable — all must be put upon the market. Hand in hand with these ideas went a limitation of retail storekeepers' profits to $16\frac{2}{3}$ per cent.[2]

The Brahmanic law exhibits similar conceptions. It laid a penalty upon any company of merchants who hurt the market for a commodity by selling it under its price, and a like one upon those members of such a company who sold an article belonging to the whole company for more than it was "worth," to their own profit. Suggestive of modern commercial usage is the following provision: He who buys unawares in open market the property of another man from one not authorized to sell it is not to blame; but the owner shall recover his property. If, however, he has bought it in secret and under its price, the purchaser and the vendor shall be punished as thieves.

These regulations all point toward an underlying conception of a just price. The things forbidden are "false" weights, "false" money values (usury), "false" commodity values (monopoly, underselling, enhancing, etc.), "false" profits, and the like. This, indeed, seems to be the normal point of view of a people whose goods and services are not evaluated in markets in the economic sense, and it will be found down through the Middle Ages, with a recrudescence with regard to monopolized commodities today. Competitive markets being practically impossible in old Oriental industry, — to this day there is no one price in the Oriental shop, — the consumer was very likely to be exploited,[1] and hence these regulations.

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[1] See *Vishnu*, V, 122–127; *Amos* viii, 4–6; *Deut.* xxv, 13–15; *Jewish Encyclopedia*, article on "Police Laws."

[2] *Jewish Encyclopedia*, before cited. Such regulations were, of course, post-exilic.

The position of the state with regard to mines and other economic agencies is significant. According to the Institutes of Vishnu, the king was to keep the whole produce of mines;[2] and let the king, so runs the pronouncement, appoint able officials for the working of his mines, for the levying of taxes and of fares to be paid at ferries, and for his elephants and forests.[3]

Labor and Caste. — With such a social and industrial organization as was possessed by these old Oriental civilizations there could have been no labor problem in the modern sense. There were wage workers, however, and in regulating the relations between employer and employee some rudiments of labor law were provided. By Brahmanic law, a hired workman who abandoned his work before the term had expired was to pay the whole amount of stipulated wages to his employer and a fine to the king.[4] What had been destroyed through his negligence must be made good to his employer. On the other hand, if an employer dismissed a workman whom he had hired before the expiration of the term agreed upon, he must pay the full amount of wages stipulated and a fine to the king, unless the workman were to blame. From the Mosaic laws little can be gathered. As wages are mentioned, there were wage earners, but their payment was probably largely in kind. The chief regulations concerned mercy and justice to the laborer, commanding the daily payment of wages [5] and warning those who oppressed the hireling.[6]

Labor was regarded as honorable by the Hebrews; but no special encouragement appears to have been given to it, except in agriculture. It was not until trade was later developed that attention was paid to the artisan wage worker, the Mosaic law showing almost no regulation of trade.

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[1] Charged "unreasonable rates," we would say.

[2] *Vishnu*, III, 56.

[3] *Ibid.*, 16.

[4] *Ibid.*, V, 153.

[5] *Deut.* xxiv, 15; *Lev.* xix, 13.

[6] *Mal.* iii, 5

Perhaps here is the place to mention briefly the economic significance of the caste system as found among the Hindus. It was, as Cossa says, division of labor gone to seed. It stood for rigidity of society and for permanent inequality among social classes, — conditions which mean a point of view in economic thought. The four castes, beginning at the top, were: Brahmanas, Kshatriyas, Vaisyas, and Sudras. The functions which the dominant elements conceived to belong to these castes were as follows:[1] Brahmanas existed to study and teach the Veda, to make sacrifices for others, and to give and accept alms; Kshatriyas were constantly to practice arms and protect the world, receiving due reward in taxes; Vaisyas were the husbandmen, tending cattle and tillage being their chief functions, with traffic and money-lending allowable; finally, the Sudra was the artist and artisan, having as his general duty the service of the superior castes. One of the great duties of the king was to keep the four castes in the practice of their several duties.

That some elasticity was possible in this system appears from the fact that in time of distress each caste might follow the occupation of the one below it In general, however, the most severe separateness was to be maintained, and any man having connection with a woman of one of the lower castes was to be put to death.[2]

Agriculture Favored. — " Although trading gives greater profits, these may all be lost in a moment; therefore, never hesitate to buy land," runs an old Rabbinical maxim;[3] and the sage author of the book of *Proverbs*, in a like vein, says, "He that tilleth the soil shall have plenty of bread." [4] In fact, although an earlier condition in which the shepherd was favored over the tiller of the soil may be indicated by the story of Abel and Cain, it has been well said that agriculture was the basis of the national life of the Israelites, state and church both being founded upon it.[1] The dominant place given to agriculture may be accounted for in part on the ground that the codes, hymns, and maxims of these Oriental civilizations were largely drawn from a time when pastoral peoples were just settling down to an agricultural life, and it seems likely that a more or less conscious purpose of the lawgivers was to fix their people in such a life.[2]

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[1] *Sacred Books of the East*, Vols. II and XIV, translations edited by Max Müller: *Vishnu*, III, 26–27, 56–62; *Vasishtha*, II, 13–20.

[2] *Vishnu*, V, 43.

[3] *Yeb.* 63 *a*.

[4] *Prov.* xii, 11 (Revised Version).

On the other hand, there was a tendency to regard trade and the crafts with disfavor. The Vaisya husbandman stood above and aloof from the Sudra artisan. The Jew came to regard the trader with a considerable degree of contempt, calling him "Canaanite." [3] To what extent it was cause, or to what extent effect, may be impossible to say, but coupled with this attitude of the Hebrews is the fact that they did not enter into commerce or manufactures to any considerable extent. In the books of *Maccabees* husbandry is mentioned, but trade is not. Josephus states that even in his time the Jews were not addicted to trade. There seems to be no evidence that free-born Israelites were artisans prior to the exile, and the crafts were accounted ignoble and left to slaves.[4] It is true that Solomon carried on commerce, but even in this case it was done through the Phœnicians, and by the government rather than the people.

This relatively high esteem for agriculture is, perhaps, not so significant as it would be in a people which had progressed further industrially, but still it remains a noteworthy characteristic of many Orientals in their attitude toward industry. And this affected their regulations both positively and negatively; it meant that much regulation of later times, with the ideas corresponding, was uncalled for; while their laws were hostile to the growth of manufactures and commerce.

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[1] *Jewish Encyclopedia*, art. "Agriculture."

[2] Cf. Kautz, *Geschichtliche Entwickelung der National Oekonomie*, p. 97.

[3] E.g., *Hosea* xii, 7, 8.

[4] Michaelis, *Laws of Moses*, Vol. I, art. xxxviii. But for cases of domestic manufacture see 1 *Chron.* iv, 21, 23; *Prov.* xxi, 19–23.

Seventh and Jubilee Years. — Quite peculiar to the Hebrew law was the institution of the seventh and jubilee years. This institution was based upon the concept of God as a king owning all the land of Israel: "The land shall not be sold for ever: for the land is mine" (*Lev.* xxv, 23). Thus, to a lawgiver who desired to prevent inequality in wealth, to preserve family and tribal property, and to keep his people attached to their country, it was easy to prohibit the permanent alienation of lands from the original possessor. This Moses did by enacting that every fiftieth year the Hebrews should "return every man unto his possession" (*Lev.* xxv, 13). It follows that a sale of land really amounted to no more than a lease, and the price necessarily varied with the remoteness of the jubilee year. This was clearly foreseen: "According to the number of years after the jubilee thou shalt buy of thy neighbor . . . for according to the number of the fruits doth he sell unto thee" (*Lev.* xxv, 15, 16).

Every seventh year was to be one in which the land lay fallow: "But in the seventh year shall be a sabbath of rest unto the land." The Rabbis emphasized the religious intent of the measure; but it seems not improbable that the economic desirability of resting the land was recognized. This provision, which at first referred to land alone, soon was given a broader significance; for, to the end that there should be no poor, creditors were commanded to release their debtors on the seventh year (*Deut.* xv, 4). Perhaps the most logical interpretation to put upon this command would be that during the seventh year interest was to be suspended — "he shall not exact it," — and then it might be connected with the fact that a general fallow would take away the means of interest payment.[1] The Talmud, however, interpreted the seventh-year provision as ordaining that debts should cease, thus making a virtual statute of limitations. When industry and trade increased, it became necessary to get around such a hampering measure by numerous subterfuges or legal fictions: thus wages, loans on pledges, notes guaranteed by mortgage, and notes waiving the right for the one particular case, came to run through one or more "seventh years."

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[1] See Michaelis, *Laws of Moses*, Vol. II. arts. 157. 159.

There seems to be no good evidence that the jubilee year, as such, was ever literally kept; the seventh year apparently was.[1]

Summary Generalizations. — Largely, though not entirely, upon the basis of the preceding facts, some broad generalizations may now be made about the economic ideas of these peoples and the underlying philosophy of life upon which their economic concepts rested.

(1) Among the most salient characteristics of their social philosophy may be mentioned its simplicity. Being in the childhood of civilization, it is not strange that they conceived of life as a whole. Their social life was in a sense undeveloped, or, better, undifferentiated, and the social sciences were in a like condition. Religion, ethics, law, economics, philosophy, were inextricably bound together.

(2) In this aggregate of social concepts the dominant member was religious or moral. In fact, it is roughly true that these Oriental civilizations were in the theological stage, passing in some cases to the metaphysical. There was a dominant priestly class, and it was this class which preserved, formulated, and handed down the traditions that both expressed and limited economic thought. The rules of the Brahmanic or Mosaic codes which bore upon economic matters had a religious significance: by following them one gained primarily, not economic well-being, but a right life, a clear conscience, or spiritual perfection. Witness the prohibition of certain foods and occupations. And the same idea is manifest in the rules of caste. Even when charity was ordained it was in like spirit, leading to an emphasis of the spiritual excellence of the giver rather than the benefit received by the poor. Or, when the Brahmans thought about poverty and unequal distribution of wealth, they simply attributed

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[1] *Neh.* x, 32; Josephus, *Antiquities of the Jews*, Bk. XIII, Chap. viii, § 1; XIV, x, 6, 16; III, xii, 3.

such evils to the sins of a previous existence and recommended that they be borne in patience. The idea of fatalism was applied to wealth. No doubt, however, a strong tendency appears, at least among the Jews, to put the secondary consideration of long life and prosperity in the foreground.

(3) A characteristic of the situation was the minute regulation of everyday life. The sacred laws of the Brahmanic civilization regulated everything, from the cleaning of one's teeth to one's funeral oblations; and the Mosaic code with its express directions concerning the sowing of vineyards, eating, and trimming hair and beard shows the same tendency. As has appeared above, many institutions which were primarily economic were thus regulated.

(4) One of the most striking characteristics of both Hebrew and Hindu economic thought, as it was expressed by philosophers and lawgivers at least, was the conflict it shows between economic stimuli and ethico-religious ideas. Those factors, subjective and objective, which tended to develop economic progress were not in harmony with these peoples' philosophy of life. Among other things, that philosophy was characterized by such a lack of individualism and of materialism, such a disapprobation of industry other than agriculture, such relative indifference toward wealth,[1] and such a degree of passivity and fatalism, that its dominance made any great industrial civilization impossible.

(*a*) Being extremely idealistic, there was an exaltation of the institution and a subordination of the individual, plainly seen in the political system. The state or the church came first, and was everything. "Above all," says Kautz, "as a controlling fundamental of the entire social and economic theory of India can be placed the esthetic self-denial and renunciation, the unreserved recognition and glorification of absolute political despotism, the denial of the personal worth of man" which it possessed.[2] Now a certain degree of individualism seems to have been necessary to the development of economic thought. Without it industry was limited by lack of motive, economic relations were simple, and economic thought largely restricted to promulgating the interests of the ruling body.

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[1] This was far less true of the Hebrews than of the Hindus, the former often indicating a keen appreciation of the good things of the earth.

[2] *Gesch. Entwickelung d. Nat. Oek.*, p. 87.

Closely related to this condition was the lack of a certain hard-headed materialism which has led the Occident to glorify the material basis for civilization, wealth. Instead of first deifying and then extolling discontent, — "divine discontent," — and continually striving to raise their standards of living, Orientals tended to limit and crystallize their standards, abolishing discontent. Their philosophy did not lead them to analyze happiness into different grades or planes of satisfaction; happiness with them was generally regarded as attained by decreasing wants. This general attitude is one which is not in harmony with the dominant note of our civilization, and it is probable that few Americans really believe that it is easier for a camel to pass through the eye of a needle than for a rich man to enter the kingdom of heaven, unless they be the poor. Between these ideals, as they find expression in Christianity, and Occidental civilization there has always been conflict, and they have become increasingly ignored in our practice.

(*b*) According to the Vedas, seeking after wealth leads to sin. Even large-scale commerce was frowned upon, and sometimes agriculture itself. The Hebrews, while sometimes decrying, sometimes also praise wealth, and on the whole by no means show the ascetic spirit of the Hindus; but as a generality the statement holds that, compared with Occidentals, they regarded wealth and non-agricultural industry with relative disfavor or indifference. They saw that riches is not the end; but went further and overlooked its utility as a means.

(*c*) The element of passivity, or economic indifference, already referred to, is not in itself peculiar to Oriental thought. It is, however, unusually strong there, and its connection with a rather rigid body of philosophy — crystallized, as it were — is, if not unique, peculiar. There it found expression in written codes; there it was part of an effective, long-continued religious system; there *it was actually applied to economic thought and practice.* To what extent this is to be attributed to climate and tropical environment need not be said. There was the tendency to accept wealth or poverty without a struggle: it was God's will, or the reward for the acts of a previous life, etc. This might be termed economic fatalism.

(5) Two further characteristics of Oriental thought, which were largely the result of points already touched upon, may be noted next. In the first place, there is its fixity and conservatism. The general aim of social regulation was to maintain the social equilibrium, and here, as elsewhere among ancient peoples, static ideals dominated. This finds expression in the caste system, and in the isolated national life. It is seen in the long-stationary condition of their civilization.[1]

(6) To say that the concept of society and social welfare was prominent may seem strange, yet the statement appears true. This concept, however, was but little like our own, for it went hand in hand with a lack of individual rights which sharply differentiates it from present-day ideas. Nor is this point made with the idea of drawing a distinction between Oriental thought and all Occidental thought. The Hindus' laws concerning weights and measures, adulteration, exchange, sanitary practice, and other matters show this concept. Among the Hebrews there were laws providing that broken glass should be buried, that water should not be thrown in the streets during the summer, and that there should be no chickens or dunghills within the city (Jerusalem).[2] Streets were not to be blocked by débris or projecting houses. For encouraging free intercourse, the

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[1] Japan not long since, China even today, has just awakened from this point of view. These peoples, from Byzantium to Japan, have lived an isolated national life and shown a large measure of national conceit, tracing their origin to the sun, etc.

[2] See *Jewish Encyclopedia*, article on "Police Laws." The strong family sense of the modern Jew and his remarkably persistent race sociality are noteworthy, though superficially he often seems a rather selfish individualist. The effect of centuries of abuse must be remembered.

width of roads was prescribed, the width being greater in the case of highways between commercial centers. And there were regulations concerning weights and measures similar in spirit to those of the Hindus. Thus one may conclude that, though the point of view was quite different, there was a sense of social solidarity expressing itself in regulatory measures which resemble in a way the legislation of recent times.

This fact may be regarded as a concomitant of their idealistic philosophy, allowance being made for the fact that their idealism was of the passive sort and so did not lead to active "social planning" and industrial "regimentation."

One writer on the history of the Hebrews has much emphasized what he calls the first appearance of Socialism.[1] Socialism, however, is not the word to use. What we find in the Bible is, first, rules ordaining a careful provision for the poor, protecting them from exploitation and from permanent debt, and enjoining free loans and charity; and then numerous attacks by the prophets upon the injustice and oppression practiced by the rich. It may be agreed that the aim of all this was a group solidarity which almost ignored the individual, and it seems that Moses had the prevention of inequality of wealth in mind in making his laws; but that does not make Socialism, and is certainly very far from social democracy. Had the Mosaic law been carried out, the result would rather have been, perhaps, like a sort of periodically enforced communism.

It remained for Christianity to put the Old-Testament ideals on a broader and more democratic basis. Moses, by limiting blood revenge and legislating mercy and charity, took a step in advance; but he only prepared the way for the Golden Rule. Similarly the Old-Testament steps toward equality of property lay back of the more humane and democratic ideals of community held up by Christ and his disciples.

Enough has been said to give a more positive and comprehensive idea of the economic thought of the Hebrews and Hindus than is generally had; and in any case Cossa's dictum that

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[1] Renan, *History of the People of Israel*, Chap. XVI.

Oriental economic thought "can all be reduced to a few moral precepts about the virtue of industry, temperance, and economy, and about the duty of only desiring wealth for the purpose of worship and charity," is clearly too narrow. It can only be so reduced at the expense of truth.

CHAPTER IV

THE ECONOMIC THOUGHT OF ARISTOTLE AND PLATO [1]

It is natural to pass from the Orient to Greece. Both by geography and by the character of her people, Greece was closely related to Asiatic civilization. However much scholars differ as to the extent of the contributions made by Asia and Africa to Greek culture, it may safely be said that such contributions were considerable. But, while certain similarities exist, there are important differences; and so directly essential has been the part played by Greek ideas in the development of modern thought that they demand no small share of attention.

More specifically, the teachings of Aristotle and Plato contained important economic ideas, and became a distinct factor in shaping economic doctrines.

Origin of the State; First Economic Interpretation of History. — One of the striking facts about the political thought of certain Greek thinkers is that it rests upon what may be truly called an economic interpretation of history. To be sure, the Athenian philosopher's conception of history was imperfect, and by an economic interpretation is not meant a materialistic one; but with these modifications, the statement is broadly true. Witness the following from Plato: "A State, . . . arises, as I conceive, out of the needs of mankind; no one is self-sufficing, but all of us have many wants. . . . Then, as we have many wants, and many persons are needed to supply them, one takes a helper for one purpose and another for another; and when these partners and helpers are gathered together in one habitation the body of inhabitants is termed a State. . . . And they exchange with one another, and one gives, and another receives, under the idea that the exchange will be for their good." [1] The origin of the state, then, is traced to the lack of individual self-sufficiency in the satisfaction of wants, and to the advantage of specialization and exchange. Such reasoning indicates an important step toward the development of economic analysis.

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[1] Some of the most useful special references are: Boeckh, A., *The Public Economy of the Athenians;* Loos, I. A., *Studies in the Politics of Aristotle and the Republic of Plato* (Bul. of the University of Iowa, 1899); Trever, A. A., *A History of Greek Economic Thought* (1916); Ashley, "Aristotle's Doctrine of Barter," *Quarterly Journal of Economics*, November, 1895; Simey, "Economic Theory among the Greeks and Romans," *Econ. Rev.*, 1900; Oncken, *Die Staatslehre des Aristoteles*, 1870–1875; Marigny, *Histoire de l'économie politique des anciens peuples;* Dubois, *Précis de l'histoire des doct. écon.*, Chap. I, and bibliography there presented. The chief sources are the *Politics* and *Ethics* of Aristotle, and Plato's *Republic* and *Laws;* and these works are available in the excellent translations by Jowett and by Welldon.

On this point, the doctrine of Aristotle, who was probably the greatest of all the thinkers of antiquity, begins in a less purely rational way. He assumes that an impulse to political association is innate in all men: "Man is naturally a social animal." The genesis of the state, however, is found in the household, which, in its turn, rests upon the inability of male and female to exist independently, and upon the inequality among men which leads to slavery. The household is "the association naturally formed for the supply of everyday wants." [2] Then comes the village, and finally the state: "Lastly, the association composed of several villages in its complete form is the State, in which the goal of full independence may be said to be first attained." The state is formed to make life possible.

Division of Labor. — Plato's discussion of specialization and exchange clearly suggests the idea of "division of labor." Indeed, the Greek philosophers' concept of division of labor, while crude, is the ultimate father of the later discussions of Hutcheson, Hume, and Adam Smith. When, however, Plato says: ". . . we must infer that all things are produced more plentifully and easily and of a better quality when one man does one thing which is natural to him and does it at the right time, and leaves other things,"[1] he does not have in mind the complex modern questions connected with division of labor. The Greek philosophers refer merely to a simple separation of employments, and their treatment lacks the significance that comes from the connection of the subject with a system of economics.

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[1] *Republic*, Bk. II, pp. 369 ff. (Ed. Steph.); *Laws*, Bk. III, pp. 678 ff.

[2] *Politics*, Bk. I, Chap. ii (Welldon, p. 3).

Their ideas concerning division of labor rested ultimately upon an analysis of human wants. The three primary wants of man, said they, are for food, clothing, and shelter. Therefore, there are at least husbandmen, weavers and shoemakers, and house builders; while smiths and carpenters come into existence to relieve the husbandmen. Exchange among these makes a merchant class necessary. Few places, moreover, are self-sufficient, hence foreign traders and sailors find employment. Meanwhile, another group, consisting of hirelings and slaves, arises. The function of the retail trades is validated on the ground that without them the seller might be compelled to wait or to depart with his goods undisposed of.

A Social Point of View Taken. — In emphasizing the advantage of division of labor, the state was thought of primarily rather than the individual, and the conclusion may be drawn that, in general, Athenian thinkers stressed the political solidarity of society. They by no means overlooked the interests of the individual, but always the individual was primarily the citizen, a citizen who, on the one hand, depended upon the state for his highest development, and who, on the other hand, by his development promoted the highest good of the whole. They exalted the state above the man; civilized man, they reasoned, is not to be thought of outside the state; without the state one is either more or less than a man. Aristotle's reasoning is in point: "Thus the state is by nature clearly prior to the family and to the individual, since the whole is of necessity prior to the part; for example, if the whole body be destroyed, there will be no foot or hand, except in an equivocal sense, as we might speak of a stone hand. . . . The proof that the state is a creation of nature and prior to the individual is that the individual, when isolated, is not self-sufficing; and therefore he is like a part in relation to the whole." [1]

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[1] *Republic*, Bk. II, p. 370.

Plato, in accord with his highly idealistic and communistic beliefs, puts the case more forcefully: You are to regard yourself and possessions "not as belonging to yourselves, but as belonging to your whole family, both past and future, and yet more do I regard both family and possessions as belonging to the state; wherefore . . . I will legislate with a view to the whole, considering what is best both for the state and for the family, esteeming as I ought the feelings of an individual at a lower rate. . . ." [2]

Indeed, regulations similar to those found among more eastern peoples were not lacking in Athens. For example, there were inspectors of weights and measures, inspectors of goods placed on sale, harbor overseers, etc. The price of salt was regulated; the exportation of wheat was forbidden; and the slaughter of sheep and goats during lambing time was not allowed. The state also pensioned those crippled in war, and in some cases gave alms to the destitute.

After all has been said, however, it must be observed that little evidence of a concept of society as distinct from the state is to be found in Greek writings. The broad and deep biological and psychological bases of social life were not understood or emphasized, but rather the Greek state was a sort of mechanical combination of individuals or families.

Inheritance. — As further evidence of this conception of society, and as an indication of the static character of the ideal, Plato's plan for regulating inheritance [3] and population [4] is of interest. In his ideal state each was to have an inalienable allotment of land. Each was to choose a single heir, adopting a son if he had no children, or choosing a husband for his daughter, if male issue were lacking. Other property might be distributed among his remaining children.[1] Clearly one object was to keep the family intact and to preserve its property to it; and these measures remind one of those adopted by the Hebrew lawgivers.

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[1] *Politics*, Bk. I, Chap. ii.

[2] Jowett's *Plato*, Vol. V, p. 310.

[3] *Laws*, Bk. V, p. 740; Bk. XI, pp. 923, 924. (Ed. Steph.)

[4] *Republic*, Bk. V, pp. 460, 461. (Ed. Steph.)

Plato charges ancient legislators with being too good-natured in allowing a man to dispose of his property by will: ". . . they were afraid of the testator's reproaches, and so they passed a law to the effect that a man should be allowed to dispose of his property in all respects as he liked; but you and I, if I am not mistaken, will have something better to say to our departing citizens," [2] and he goes on to express his belief that the interest of the state should predominate.

All this is surely suggestive as to present-day questions of regulating inheritances.

Population. — But the question arises, what was to become of children other than those who were heirs to the father's lot? In answer, Plato provided for a careful regulation of population. This was necessary to preserve the social equilibrium. His state was to consist of a limited number of citizens (5040). If the number began to decrease, prizes might be offered to encourage a growth of population; if there were an excess, colonies would be established. In this way that precise regulation of life contemplated by the philosopher might be rendered possible.

Thus the thought of the leading Athenian philosophers was hardly individualistic, though they went further than the Orientals in recognizing the importance to the state (society) of its individual members; for, like their government, the spirit of their philosophy was somewhat more democratic, and they saw that the welfare of the state depended upon that of the individual.

Communism. — Probably the most discussed phase of that part of Greek philosophy which has distinct economic bearing is communism. As this subject has a close relationship to the question of social solidarity and individualism, it is naturally mentioned in this connection.

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[1] This was in Plato's second-best state, where communism of wives and children did not obtain.

[2] Jowett's *Plato*, Vol. V, pp. 310, 311.

Plato and Aristotle differed greatly in their ideas as to the scope to be given communism. Plato desired a complete communism, embracing not only property, but also wives and children. He did not give the details of his scheme for communism in property. He made it clear, however, that his object was to promote harmony by removing the ground for civil suits and uniting all citizens by common interests. His ideal state is characterized by a community of wives and children, partly with the aim of diminishing discord and jealousy, partly with the idea of eugenics and control of population. "The children of the inferior, or of the better when they chance to be deformed, will be put away in some mysterious, unknown place, as they should be. . . . This must be done if the breed of guardians is to be kept pure." Thus Plato's communism did not stand for an absolute mechanical equality, but recognized authority and class distinctions.

Aristotle was entirely opposed to Plato's communism of wives, and did not go any great way with him as to property. His arguments against communism are classic.

> "Next let us consider what should be our arrangements about property: should the citizens of the perfect state have their possessions in common or not? This question may be discussed separately from the enactments about women and children. Even supposing that the women and children belong to individuals, according to the custom which is at present universal, may there not be an advantage in having and using possessions in common? Three cases are possible: (1) The soil may be appropriated, but the produce may be thrown for consumption into the common stock; and this is the practice of some nations. Or (2) the soil may be common, and may be cultivated in common, but the produce divided among individuals for their private use; this is a form of common property which is said to exist among certain barbarians. Or (3) the soil and the produce may be alike common.
>
> "When the husbandmen are not the owners, the case will be different and easier to deal with; but when they till the ground themselves the question of ownership will give a world of trouble. If they

do not share equally in enjoyments and toils, those who labour much and get little will necessarily complain of those who labour little and receive or consume much. There is always a difficulty in men living together and having things in common, but especially in their having common property. The partnerships of fellow-travellers are an example to the point; for they generally fall out by the way and quarrel about any trifle which turns up. So with servants: we are most liable to take offence at those with whom we most frequently come into contact in daily life.

"These are only some of the disadvantages which attend the community of property; the present arrangement, if improved, as it might be by good customs and laws, would be far better, and would have the advantages of both systems. Property should be in a certain sense common, but, as a general rule, private; for, when every one has a distinct interest, men will not complain of one another, and they will make more progress, because every one will be attending to his own business; and yet among the good, and in respect of use, 'Friends,' as the proverb says, 'will have all things common.' Even now there are traces of such a principle, showing that it is not impracticable, but, in well-ordered states, exists already to a certain extent and may be carried further. For, although every man has his own property, some things he will place at the disposal of his friends, while of others he shares the use with them. The Lacedæmonians, for example, use one another's slaves, and horses, and dogs, as if they were their own; and when they happen to be in the country, they appropriate in the fields whatever provisions they want. It is clearly better that property should be private, but the use of it common; and the special business of the legislator is to create in men this benevolent disposition. Again, how immeasurably greater is the pleasure, when a man feels a thing to be his own; for the love of self is a feeling implanted by nature and not given in vain, although selfishness is rightly censured; this, however, is not the mere love of self, but the love of self in excess, like the miser's love of money; for all, or almost all, men love money, and other such objects in a measure. And further, there is the greatest pleasure in doing a kindness or service to friends or guests or companions, which can only be rendered when a man has private property. The advantage is lost by the excessive unification of the state. Two virtues are annihilated in such a state; first, temperance towards women (for it is an honourable action to abstain from another's wife for temperance' sake); secondly, liberality in the matter of property."[1]

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[1] *Politics*, Bk. II, Chap. v.

Aristotle, it will be observed, although opposing Plato's ideas, did not rush to the opposite extremes. Some things should be private; some should be held in common. He desired that more things should be common than there then were, and protested against the excessive individualism of the Greeks. He advocated common meals, and especially noteworthy is his wish for a certain community in the use of property along with its private ownership.

Aristotle did not confuse the end, happiness, with the means, as radical reformers are so apt to do. Thus he did not stand for an equality in goods, but for equality in want-satisfactions, a position which is in accord with idealism in that it recognizes the importance of differences in the wants of different individuals.

It must not for a moment be fancied that these ancient philosophers thought of communism as implying any general democracy. Quite the reverse. There were three classes of men fashioned in the bowels of the earth, one of gold, another of silver, the third of iron or copper. These were, respectively, the philosophers or guardians, the warriors or auxiliaries, and the artisans and tradesmen. Such communism as they advocated was to be applied to the first two alone. It was an aristocratic communism. Slavery was considered to be "natural."

Scope and Classification of Aristotle's Economic Thought. — The nearest approach made by Greek philosophy to developing a distinct theory of economics came in discussing the elements of household management. Here a distinction was drawn between economics (*oikonomik*) and chrematistics (*chrematistik*); the former embraces chiefly wealth consumption in the satisfaction of wants, and the provision of such necessary and useful commodities as can be stored to meet those wants; the latter deals with wealth-getting, including money-making and exchange. Concerning the latter, Aristotle says, "And there is another element of a household, the so-called art of money-making (or finance) which, according to some, is identical with household management, according to others, a principal part of it." [1]

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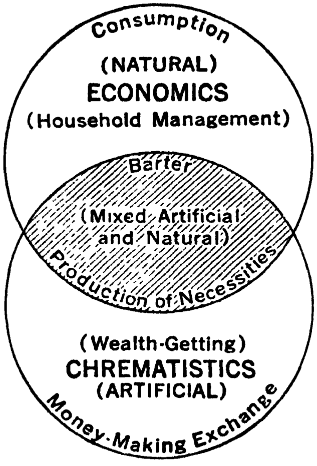
[1] Aristotle, *Politics*, Bk. I, Chap. iii.

There are two kinds of chrematistics: the natural and the unnatural. Thus the first simple barter by which things are given in exchange for what one wants "is not contrary to nature, but is needed for the satisfaction of men's natural wants";[1] but "retail trade is not a natural part of the art of money-making."[2] Or, again, husbandry and stock-raising make the "true or proper art of money-making," while the *other* consists in exchange.[3] It is the "natural" or "proper" branch of chrematistics alone which should be included in economics or household management (*Wirtschaft*).[4] Thus Aristotle's classification might be represented by the accompanying diagram.



Closely connected with the preceding analysis is the distinction between the natural or proper and the unnatural or improper uses of a thing. "Of everything which we possess there are two uses: both belong to the thing as such, but not in the same manner, for one is the proper, the other the improper or secondary use of it. For example, a shoe is used for wear, and is used for exchange; both are uses of the shoe."[5] This distinction rests upon Aristotle's notion of exchange, which, in its turn, is founded on the idea that *there is a certain consumption which is sufficient for a proper life*; for, when he says that retail trade is not a "natural" part of money-making, he adds that "had it been so, men would have ceased to exchange *when they had enough*." In other words, natural chrematistics concerns the satisfaction of natural or proper wants by "natural" or "proper" or "primary" uses.

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[1] Aristotle, *Politics*, Bk. I, Chap. ix.

[2] *Ibid.*

[3] *Ibid.*, Bk. I, Chap. xi.

[4] *Ibid.*, Bk. I, Chap. viii.

[5] *Ibid.*, Bk. I, Chap. ix.

This idea clearly suggests later distinctions between value in use and value in exchange. Its consciously ethical content, however, is absent from much of the later usage. In the same idea, a trace of the notion held by some later economists (the Physiocrats) may be distinguished, namely, the notion that extractive industries are the only ones which are productive. One could easily get the idea from Aristotle that the growing, or digging up, or catching of things which satisfy the more elemental wants in the simplest way, is more productive than the elaboration of these things by artisans or their exchange by merchants, — that the latter occupations do not add to the real wealth of the state.

Value. — The idea of value received little attention, and that little was from the point of view of ethics or justice. Plato says that according to law a man "should not attempt to raise the price, but simply ask the value,"[1] implying that value is an absolute quality inherent in the thing. This, however, is but a rudimentary discussion of the subject. Aristotle goes further. His notion of value is clearly subjective, and is based upon the usefulness of the commodity concerned.[2] All things which are exchanged must be comparable through some standard of measure, and this standard he finds in man's wants: "In the truest and most real sense, this standard lies in wants, which is the basis of all association among men." An exchange is just, when each gets exactly as much as he gives the other; yet this equality does not mean equal costs, but equal wants. If men want the cobbler's product more than the husbandman's, more grain must be given for shoes.

Money is the medium which makes wants commensurable.

Money and Interest. — As regards that particular form of wealth known as money, the teaching of the Greeks has been of signal importance in the history of economic thought. In general, they saw and explained the necessity of money, and recognized a part of its economic function, namely as a medium of exchange. Aristotle is especially explicit. He remarks that

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[1] *Laws*, Bk. XI, p. 921. (Ed. Steph.)

[2] See *Politics*, Bk. I, Chap. ix; *Ethics*, Bk. V, Chap. 8.

"as the benefits of commerce were more widely extended . . ., the use of a currency was an indispensable device. As the necessaries of nature were not all easily portable, people agreed for purposes of barter mutually to give and receive some article, which, while it was itself a commodity, was practically easy to handle in the business of life, some such article as iron or silver, which was at first defined simply by size and weight; although finally they went further and set a stamp upon every coin to relieve them from the trouble of weighing it. . . ." [1] And he goes on to distinguish between money and wealth, referring to the fable of King Midas. Aristotle elsewhere clearly shows an understanding of money's functions as a measure of value and a standard of deferred payments.[2]

Xenophon is equally clear in distinguishing between money and wealth.[3]

Plato, in keeping with his more communistic ideals, would have had no gold nor silver for the private man, but only domestic coins to be used in payment of hirelings and the like;[4] but he thought that the state should have a common Hellenic currency for the use of embassies, expeditions, and journeys.

With all this, however, the thought of these men was tainted with error. They virtually regarded money as nothing but a medium of exchange, and, as such, they denied the productivity of loans of it. A piece of money cannot beget another piece, was the doctrine of Aristotle, and no economic idea of his had more lasting effects. The obvious conclusion was that interest is unjust.[5] Plato, too, seems to have thought that neither should interest be given nor even the principal of a debt be repaid.[6]

It must not be supposed, however, that this view of interest which seems so strange to us owed its existence entirely to the inferior insight of the ancients. It is to be explained largely by economic conditions. In Athens the circulation of capital was inconsiderable, and money was not lent for productive purposes so often as for the purpose of relieving distress. If today loans were chiefly made to embarrassed friends or neighbors to be used in alleviating distress in matters of consumption, we too would undoubtedly regard interest in a different light. The modern theory of interest is based upon loans for productive investment.[1]

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[1] *Politics*, Bk. I, Chap. ix (Welldon).

[2] *Nichomachean Ethics*, Bk. V.

[3] *Revenues of Athens*. We pass over Xenophon with a mention or two, for he appears to have limited his economic thought to practical business rules and a few observations about money. He might be classed as a sort of mercantilist.

[4] *Laws*, Bk. V, p. 742 (Jowett, *The Dialogues of Plato*, Vol. V, p. 124).

[5] *Politics*, Bk. I, Chap. x.

[6] *Laws*, Bk. V, p. 742. This may be compared with the Hebrew idea of a loan—see above, pp. 41 f.

Another erroneous monetary idea, which was held by Xenophon at least, was that the value of silver is absolutely fixed regardless of supply. Aristotle, however, recognized that the value of money is subject to the same law as other things and that it is liable to change, although it tends to be more constant.[2]

Industry and the Various Occupations. — Like the Oriental lawgivers, Athenian philosophers favored some branches of industry and regarded others with disapprobation. Agriculture was considered most desirable. "But strictly speaking," writes Aristotle, ". . . the means of life must be provided beforehand by nature; for the business of nature is to furnish food to that which is born, and the food of the offspring always remains over in the parent. Wherefore, the art of making money out of fruits and animals is always natural." Husbandry and stock-raising were the natural or proper arts. Exchange, including commerce, usury, and services for hire, were not natural. Mining and lumbering lay midway between.[3]

Plato thought that the precious metals ought not to be allowed in his state, "nor much of the vulgar sort of trade which is carried on by lending money, or rearing the meaner kinds of livestock; but only the produce of agriculture, and only so much of this as will not compel us in pursuing it to neglect that for the sake of which riches exist, — I mean, soul and body." [4]

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[1] Cf. Schönberg's *Handbuch der Politischen Oekonomie* (Tübingen, 1882), Bd. I, s. 60.

[2] *Ethics*, Bk. V, Chap. 8.

[3] Aristotle, *Politics*, Bk. I, Chaps. x and xi.

[4] Plato, *Laws*, Bk. V, p. 743 (Jowett, *The Dialogues of Plato*, Vol. V, p. 126).

Riches. — In their attitude toward riches these Greek thinkers are notable for their poise. Great stores of wealth were decried by them; as was also poverty. Clearly recognizing the usefulness of an abundance of material things as a *means*, they yet sought the happy medium. Riches in excess were disfavored on two grounds. As a matter of economy, it was argued that they decreased efficiency in production. In a celebrated bit of dialogue Plato develops the idea thus: —

> "There seem to be two causes of the deterioration of the arts.
>
> "What are they?
>
> "Wealth, I said, and poverty.
>
> "How do they act?
>
> "The process is as follows: When a potter becomes rich, will he, think you, any longer take the same pains with his art?
>
> "Certainly not.
>
> "He will grow more and more indolent and careless?
>
> "Very true.
>
> "And the result will be that he becomes a worse potter?
>
> "Yes; he greatly deteriorates.
>
> "But, on the other hand, if he has no money, and cannot provide himself with tools or instruments, he will not work equally well himself, nor will he teach his sons or apprentices to work equally well." [1]

A second reason for opposing extreme riches was ethical. Plato argues that great riches and happiness are incompatible; for a rich man cannot be a perfectly good man, as part of his wealth must necessarily be acquired and expended unjustly.[2] The reasoning is of much interest in connection with present-day ethics of wealth, and must be quoted to be appreciated.

> "The citizen must indeed be happy and good, and the legislator will seek to make him so; but very rich and very good at the same time he cannot be, not, at least, in the sense in which the many speak of riches. For they mean by 'the rich' the few who have the most valuable possessions, although the owner of them may quite well be a rogue. And if this is true, I can never assent to the doctrine that the rich man will be happy — he must be good as well as rich. And

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[1] *Republic*, Bk. IV, p. 421 (Jowett's *Plato*, Vol. III, pp. 109–110, 119–121).
[2] *Ibid.*, Bk. V, pp. 742–744 (Jowett, Vol. V, pp. 125, 126).

> good in a high degree, and rich in a high degree at the same time, he cannot be. Some one will ask, why not? And we shall answer — Because acquisitions which come from sources which are just and unjust indifferently are more than double those which come from just sources only; and the sums which are expended neither honourably nor disgracefully, are only half as great as those which are expended honourably and on honourable purposes. Thus, if the one acquires double and spends half, the other who is in the opposite case and is a good man cannot possibly be wealthier than he. The first — I am speaking of the saver and not of the spender — is not always bad; he may indeed in some cases be utterly bad, but, as I was saying, a good man he never is. For he who receives money unjustly as well as justly, and spends neither justly nor unjustly, will be a rich man if he be also thrifty. On the other hand, the utterly bad is in general profligate, and therefore, very poor; while he who spends on noble objects, and acquires wealth by just means only, can hardly be remarkable for riches, any more than he can be very poor. Our statement, then, is true, that the very rich are not good, and, if they are not good, they are not happy."

Aristotle also opposed extremes, though, quite consistently with his views as to communism, he was not opposed to reasonable inequalities. He dreaded more the encroachments of the rich than those of the people. "Many . . . make a mistake," he says, "not only in giving too much power to the rich, but in attempting to overreach the people. There comes a time when out of a false good there arises a true evil, since the encroachments of the rich are more destructive to the State than those of the people." [1] On the other hand he remarks, "Poverty is the parent of revolution and crime." [2]

The Greek Stoics and Epicureans. — While Aristotle and Plato made the chief direct Greek contributions to economic thought, one must remember that such thought is greatly influenced by epistemological and ethical ideas. Even the economist, therefore, should not leave a discussion of Greek philosophers without some mention of Zeno and Epicurus.

Zeno, who was the founder of Stoicism, emphasized virtue above all else, and treated it not only as the source of happiness but as the goal of human life. The Stoics believed that pleasure is not to be sought for itself — that it is the by-product of a virtuous life. Incidentally, they taught that the individual exists for society, which alone makes virtue possible. The idea of a "moral sense" innate in man, is implied. Thus Stoicism had idealistic tendencies. It also contained, however, a vague concept of living "in accord with nature." Accordingly, Stoicism was to affect economics through its contributions both to (1) the idea of a "law of nature," and to (2) the optimistic idea that the individual has an innate sense of justice which may be relied upon.

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[1] Jowett, *The Politics of Aristotle*, p. 131 (*Politics*, Bk. IV, 12, 6). See also *ibid.*, p. 45 (II, 7, 13).

[2] *Ibid.*, p. 40 (II, 6. 13).

The Epicureans, on the other hand, made pleasure the goal of life; and they found pleasure to lie in sensations (not necessarily "sensual"). Their thought was thus materialistic and hedonistic, and this thought tendency came to dominate economics during part of the nineteenth century.

Of both these schools of philosophy it may be said that they tended toward sensationalism and the doctrine that knowledge comes only through the senses, which doctrines have a bearing upon the nature and determination of economic value, and upon the nature and validity of economic law. And both strongly tended to minimize the individual's responsibility toward his fellows. The Stoic could say, "If social troubles are the result of natural law, am I to blame?" The Epicurean (who, incidentally, believed in no God) could ask, "If right lies in my pursuit of pleasure, what responsibility have I for wrong doing? Indeed, what *is* wrong?"

Ethics Dominant. — It is to be emphasized that the ideal of most of the Greek thinkers was highly ethical. To be happy one must be good, was a dominant note, and the interests of the soul were placed foremost. "For there are in all three things," Plato says,[1] "about which every man has an interest; and the interest about money, when rightly regarded, is the third and lowest of them: midway comes the interest of the body; and, first of all, that of the soul; and the state which we are describing will have been rightly constituted if it ordains honours according to this scale." And Aristotle's dictum is: "But a state exists for the sake of a good life and not for the sake of life only." [1]

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[1] *Laws*, Bk. V, p. 743 (Jowett, *The Dialogues of Plato*, Vol. V, p. 126).

If one could conceive of Plato making a definition of economics, one might imagine it would run somewhat as follows: "Economics is the science which deals with the satisfaction of human wants through exchange, seeking so to regulate the industries of the state as to make its citizens good and happy and so promote the highest well-being of the whole." That would make it an applied science, in which ethical aims would play a great part.

Summary. — From the foregoing discussion we may draw certain summary generalizations concerning the fundamentals of the economic thought of Aristotle and Plato:

a. *Passive Idealism.* — The spirit was considered to exist independently of the body. Innate differences among men were emphasized. Man's wants were held to be of *primary* importance in valuations; but wants were to be directed and limited according to ideals. Man-made institutions were given an important part. But after all, man wins only by making certain adjustments in his conduct. (A recognition of the limited perfectibility of mankind, and of the necessity of man's adjusting himself to some extent to his environment, makes their idealism less extreme, particularly in Aristotle's case.)

b. *Subjective Standards and an Emphasis on Human Wants.* — Objective tests were not accepted as validating economic phenomena, for example, market prices. Some concept of "just" valuation, or the "just price" idea, and an emphasis on " value in use," or "utility," were corollaries. Justice in exchange, said Aristotle, depends upon wants. Similarly specialization of occupation, and the state itself, depend upon man's wants.

c. *A Subordination of Individual to State, Accompanied by a Leaning toward an Undemocratic Sort of Communism.* — The individual was regarded as a dependent part of the whole —

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[1] *Politics*, Bk. III, Chap. ix.

the state. Thus there could be no real democracy, at least in the nineteenth-century sense. Their thought was opposed to the social contract concept of the state and tended toward an organismic concept.

d. *A Normative Economics Mixed with Politics.* — They thought of a purposive economy, with the state existing for the sake of "the good life." Ideals or standards of perfection were set up. Free choices by individuals were not accepted as the test. Economic values were so mixed with ethical and political values, that the science of Economics, as it was to develop later, was impossible.

Contrast with Hebrews and Hindus. — As already observed, there are important differences between the economic ideas of the Hebrews, Hindus, and other Oriental peoples, and those of the Athenian philosophers. They were similar in emphasizing the state, and the ethical point of view. Neither differentiated economics from politics or morals. Both were conservative and undemocratic. Moreover, with both, agriculture was the only industry in very good repute. But the Greeks were more concerned with the individual, going further in the analysis of the state into its citizens. They, too, were possessed of some small degree of historical method, though it was quite abstract. They analyzed economic wants, and based the *oikonomik* and *chrematistik* of their philosophy upon this analysis. The Athenian philosophers were more appreciative of material wealth as an agency in furthering human happiness than were the sacred writers of the Hindus, at least. The well-known care for the body by the Greeks had its economic significance.

Most important of all, the Greeks were more rational. Instead of forbidding interest in pursuance of some divine edict, they argued about it and reached the conclusion that it was unjust. Thus the writings of Plato and Aristotle mark a great step in advance in economic method, as well as in scope and depth of analysis.

CHAPTER V

THE ECONOMIC THOUGHT OF THE ROMANS[1]

From Greece the scepter passed to Italy, and the glory of Greek thought became merged in the grandeur that was Rome's. No pause need be made to retail the very scanty information we have about early Roman thought, before the stimulus of Greek ideas had been received. Suffice it to say that aside from jurisprudence, the chief writings of the Romans were produced under the influence of Greek thought, and, as in the case of their art, a notable lack of freshness and originality is apparent.

The Athenians were thinkers, keen and analytic. The Romans were men of action, warriors and statesmen. The former left a philosophy which profoundly affected the ethics and economics of later thinkers; the latter built institutions which as profoundly affected law and politics. The heritage of the one has been a direct and subjective force; the other, chiefly indirect and objective, conditioning the thought of the individual. As will appear in a moment, however, Roman thought has had more direct influence than its intrinsic depth would account for.

Of especial interest is the fact that the decay of Rome was well under way when her chief writers were engaged on their works. This fact colored their writings and conditioned their economic ideas. The state of decay was at least half perceived by them, and remedies were pointed out for the evils discerned. The causes and remedies as they presented themselves — say in the time of Cæsar — were only in part economic; but the economic ideas of the Roman philosophers were largely palliatives for a declining state.

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[1] Oertmann, *Die Volkswirtschaftslehre des Corpus Juris Civilis* (Berlin, 1891); Hoffmeister, *Die wirtschaftliche Entwickelung Roms* (Vienna, 1899); Oncken, *Geschichte der Nationaloekonomie* (Leipzig, 1902); Palgrave's *Dictionary of Political Economy*, article on "Civil Law"; footnote references in this chapter.

Roman economic ideas may be gathered from two main sources: (1) the jurists and writers on legal matters; (2) the philosophers.[1] Of less importance are (3) a few writers on agriculture (*de re rustica*); their ideas were either purely technical or fall under the philosophical group.

Economic Thought of the Jurists. — Among the jurists are found the most original Roman thinkers, and the laws express the best Roman thought. No system of economics is expressed or implied, and ethical or political considerations outweigh those economic; but the following brief generalizations are of economic significance.

a. *Natural Law.* — The Roman jurists made a distinction between human law and natural law which had much influence upon medieval and later thought. Their *jus civile* was a national law applicable to Roman citizens. On the other hand, a body of law known as *jus gentium* was developed for foreigners of whatever nationality. The latter was broader and less guided by arbitrary local customs. It was more rational. Yet, at the same time, being so founded on general principles, it contained within itself the capacity for abstract absolutism in thought. Later it was united with the Greek concept of the natural, and as a *jus naturale* colored succeeding thought.[2]

b. *Private Property and Contract.* — In their ideas about two legal institutions, the jurists have had great effect in an objective way upon the development of economic thought; these are the institutions of property and of contract. Theirs was a somewhat narrowly individualistic idea of property. Under the stimulus of Stoic philosophy and the ideal of a *jus naturale*, the thought of the jurists moved away from the clan or family as a social unit, and clearly defined individual rights replaced whatever community of property there had been.[3]

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[1] Others, as religious or theological writers, no doubt influenced economic thought and institutions indirectly.

[2] Cf. Maine, *Ancient Law*, pp. 56, 88; Carlyle, R. W., and A. J., *A History of Medieval Political Theory.*

[3] The nature and scope of property rights changed at the same time, of course. At first property belonged to the family group and was alienated by the *pater familias* only with difficulty.

And a corollary of this movement was the development of freedom of contract, including the right of the individual to dispose of his property. The importance of these institutions as a basis for all economic processes, and their liability to abuse, are apparent. As a great English economist has said, "to Roman . . . influence we may trace indirectly much of the good and evil of our present economic system; on the one hand much of the untrammelled vigour of the individual in managing his own affairs, and on the other not a little harsh wrong done under the cover of rights, established by a system of law which has held its ground because its main principles are wise and just."[1]

An important characteristic of Roman economic thought is the separation of the non-personal elements in law from the personal, and the emphasis placed upon the former. In this it stands in contrast with the Stoic philosophy and with religious tendencies. In fact, one of the services of Roman thought was to divorce law from religion. This placing of the law upon a more impersonal basis doubtless facilitated the development of the Roman legal system in a scientific way. As a result, however, Roman juristic philosophy seems one-sided to us, in that it does not appear to attach sufficient importance to the human personality and to personal rights. This characteristic may be seen in the tendency to base right upon might, the law, in earlier stages of Rome's development, regarding conquest as giving the best title to property, and considering the enslavement of debtors as a just power of creditors. In private life the *pater familias* alone had full rights as a person; and the individualism of the Romans, like freedom of contract among them, applied only to certain favored classes of men.

It is evident that, in so far as it has affected economic thought, — and with the development of commerce after the Crusades it came to have an increasing influence, — Roman law lent itself to the tendency to make economics a science of exchanges determined by the working of impersonal laws.

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[1] Marshall, *Principles of Economics*, p. 23, 4th ed.

c. *Money and Interest.* — Worthy of mention is the fact that Roman jurists had a good appreciation of money.[1] Besides having a clear idea of its advantages for exchange purposes, they saw that it was, in a sense, merely a commodity of a more or less changeable value, — a value which is essential to its function and which cannot be established by law.

In the earlier periods of Roman history, the law appears on the whole to have opposed interest-taking. The Laws of the Twelve Tables fixed the interest rate, but condemned usury, thus recognizing a distinction between the two. In 357 B.C. the rate was changed to 10 per cent; in 347 it was cut to 5 per cent; and five years later interest was forbidden entirely by the Genucian Laws.

But with conquest and the growth of wealth things changed. Borrowing and lending were great in amount and widespread, large gains being made by borrowing at from 4 to 8 per cent in Rome and lending in the provinces at such enormous rates as, for example, 48 per cent. Finally, the Institutes of Justinian fixed rates of from 4 to 8 per cent, according to the character of the loan. Such legislation, however, seems to have been practically a dead letter, the actual rate varying with market conditions.

Economic Thought of the Philosophers. — While the jurist said, thou shalt, the philosopher was saying, thou shouldst. Though the genius of the Romans was certainly far less ethical than that of the more speculative Athenians, yet Roman philosophers generally let ethical notions take the place of scientific principles; as, for example, Cicero said that the universal opinion ought to be "brought over to the hope that men may learn to expect the attainment of what they desire by right purposes and honest deeds, not by fraud and roguery," [1] and again, "Let it be settled then, that what is wrong is never expedient." [2]

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[1] The following statement of the origin and use of money by the jurist Paulus has become famous. "Purchase and sale arose from exchanges; for formerly there was not money as now, nor was one thing called ware and another price, but each according to his necessities used to exchange things lacking utility for those which had it, since it often happens that what one has an abundance of another lacks. But because it does not always nor readily happen that when you have what I desire, I in turn have what you are willing to receive, a material is chosen whose valuation being permanent and fixed by the state (*publica ac perpetua aestimatio*) should remedy the difficulties of exchanges by equality of value in given quantities; and this material being struck with a public form (*i.e.* coined) represents usefulness and effectiveness not so much from intrinsic value as from (value in a given) quantity, both being called wares no longer, but the one called price." Cf. Aristotle's words, above, p. 66.

Dig. de contrah. empt. xviii, 1; quoted by Kautz, *Geschich. Entwickelung d. Nat. Oek.*, p. 173. See Moyle, *Contract of Sale in Civil Law*, pp. 3, 221. Kautz's citation seems faulty in grammar and punctuation.

The chief writers of this class were Cicero, Seneca, and Pliny the Elder; and the younger Pliny, Marcus Aurelius, and Epictetus may be mentioned. Of all, it can be said that they decried the luxury and vices of their time, contemning the thirst for riches — especially money — and preaching moderation. Looking back at the good old days, they praised a simpler agricultural economy. *O tempora! O mores!* Such was Rome's state that her philosophers dreamed of the simple life and called, "back to nature!"

While there is more insistence on a competency of worldly goods than among the idealistic Greeks and the religious Hebrews, there is not one of these philosophers but would have echoed the words, "The love of money is the root of evil." The Greek philosophers' view of interest also prevailed. Cicero tells us that Cato thought usury, i.e., interest, as bad as murder, saying, "Would you take interest? would you kill a man?" Seneca condemned interest-taking on the same ground as Aristotle.[3] Indeed it must be said of these writers, as of the Greeks, that they did not fully appreciate the nature and functions of money, not to mention capital as a whole.

Quietism and Nature Philosophy. — It was the philosophy of the Stoics which not only influenced Roman legal conceptions but exerted an important direct influence upon later economic thought. This philosophy was tinged with a spirit of quietism which induced in many that economic fatalism so characteristic of Oriental thought.[4] For example, Marcus Aurelius meditated as follows: "Be satisfied with your business, and learn to love what you were bred to do; and as to the remainder of your life, be entirely resigned, and let the gods do their pleasure with your body and soul."[1] Happiness, the Stoics believed, lies not in outward things, but in conquest of desires and passions; hence their thought was naturally not directed toward increasing the production or even improving the distribution of wealth. This belief, implying the desirability or necessity of man's making adjustments to environment, would tend to prevent or remove a sense of individual responsibility for social ills, and to beget a sort of inertia in dealing with social problems.

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[1] *De Officiis*, Bk. II, Chap. 3.

[2] *Ibid.*, Bk. III, Chap. 10.

[3] *De Beneficiis*, VII, 10 (Kautz, p. 156).

[4] Above, pp. 51, 52.

The Stoics' nature philosophy had a similar tendency, in that, according to it, the part of the wise man is to "follow nature." Nature follows law, they reasoned, — the universe is systematic and rational, — therefore it is the part of wisdom to submit calmly to the all-pervading law of nature.

This concept of a law of nature held an important place in Roman thought.[2] Its connection with the *jus naturale* of the jurists is especially noteworthy: of both it may be said that the idea was one of a universal cosmopolitan and eternal law, which either corresponds to man's innate convictions of right, or must be accepted as the controlling factor in human action. Both as part of Stoic philosophy and as a doctrine of Roman law, this concept, as will appear, played a considerable part at the birth of economic science in the eighteenth century.

At first glance, Stoicism would appear to be idealistic in tendency; but as a matter of fact its influence has generally worked with materialism in economic thought, illustrating how extremes meet. The concept of a law of nature whose principles are innate in man, the ideas that a man is a law unto himself and that happiness does not lie in outward things, savor of the ideal. But, the Stoics regarded sensations as the source of knowledge, and while they exalted reason they gave it a material basis. In holding that a man must submit to the all-pervading, rational law of nature, — which led to a species of fatalism — they gave an objective materialistic cast to that law. In short, while they believed that man *can* make adjustments to natural law and thus may gain happiness, they also believed that it is possible for him to do so *only by conforming to natural law.* The influence of such philosophy upon economics may be seen in the thought of the Physiocrats and Adam Smith.[1]

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[1] *Meditations of Marcus Aurelius*, IV, 31.

[2] Even Cicero, though an adherent of the New Academy, with its Peripatetic tendencies, wrote his ethical works with a dominant Stoic strain.

Agriculture the Only Honorable Industry. — A limitation upon Roman economic thought, one common to Romans and Greeks, was the prevailing idea that the only honorable industry is agriculture.. Cicero may be regarded as typical in this respect, and he wrote: "Now as to the trades and modes of getting gain that are to be regarded as respectable, and those that are to be deemed mean and vulgar, the general opinion is as follows: In the first place, those callings are held in disesteem that come into collision with the ill will of men, as that of taxgatherers, as that of usurers. The callings of hired laborers, and of all who are paid for their mere work and not for skill, are ungenteel and vulgar; for their wages are given for menial service. Those who buy to sell again as soon as they can are to be accounted as vulgar; for they can make no profit except by a certain amount of falsehood, and nothing is meaner than falsehood. All mechanics are engaged in vulgar business; for a workshop can have nothing respectable about it. Least of all can we speak well of the trades that minister to sensual pleasures, —

> 'Fishmongers, butchers, cooks, poulterers, and fishermen,'

as Terence says. Add, if you please, to this list perfumers, ballet-dancers, and the whole tribe of dice-players. The professions which require greater skill and are of no small benefit to the community, such as medicine, architecture, and the instruction of youth in liberal studies, are respectable for those whose rank they suit. Commerce, if on a small scale, is to be regarded as vulgar; but if large and rich, importing much from all quarters, and making extensive sales without fraud, it is not so very discreditable. . . . But of all means of acquiring gain, nothing is better than agriculture, nothing more productive, nothing more pleasant, nothing more worthy of a man of liberal mind." [1]

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[1] See below, pp. 178 ff., 234 f.

Practical Tendencies. — Though there was a feeling of disfavor among the upper classes, at least, toward the crafts and small-scale commerce, and the quietism in thought just noted, still the Romans were notably careful in business relations and matters of account. Many instances might be cited of their accurate and cautious manner of recording both public and private transactions.[2] Moreover, there is evidence that credit institutions similar to the check and promissory note were known and used, while Cicero requested Curius to honor Tiro's draft for any amount and asked Atticus to ascertain if he could get exchange in Athens.[3] While of little direct significance as to economic thought, these facts would indicate that, although lacking in theoretical analysis, the Romans must have had many concrete ideas about economic relationships.

Writers on Agriculture. — Chief among the *scriptores de re rustica*, or writers on agriculture, were Cato, Varro, and Columella. These writers produced semi-technical treatises on rural economy, dealing with the production of wine, oil, etc., the raising of different grain crops, and grazing. Then, in the introduction or some concluding book, general principles of private economy were added. They agree in decrying the *latifundia*, or large estates, absenteeism, and the spread of slavery, and in praising small-scale farming. Their pretty general condemnation of slavery *on economic grounds* is especially noteworthy.

Varro's statement is typical: "To this whole class of free men [who till fields] the statement is applicable that it pays to use hired help rather than slave labor at all times in disease-laden districts, and even in the healthful regions as well for the more difficult tasks of husbandry like the harvesting of the vintage and the crops."[1]

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[1] *De Officiis*, Bk. I.

[2] See, e.g., Oliver, *Roman Economic Conditions to the Close of the Republic* (University of Toronto, 1907), pp. 130–131.

[3] *Ep. ad Fam.*, XVI, iv, 2; XI, i, 2; XII, xxiv, 1.

Originally, the Romans were a stern and war-like folk, of simple tastes. As a people, they always dreaded the sea, and were slow to engage in foreign trade.[2] It was only after military conquest had enriched them with booty, therefore, that they acquired luxuries and luxurious tastes which necessitated commerce. At the same time the use of slaves increased to great proportions, while there was a concomitant destruction of the independent yeoman class. Land was cultivated in the form of great estates, *latifundia*, for absentee landlords, while an increasing mass of free but impoverished citizens was maintained in the cities at the public expense. This meant a growing separation of classes. It is little wonder then that the writers of the degenerate period turned longing eyes upon the simple rural life of bygone days.

The similarity between Rome's later days and the condition of France in the eighteenth century has been noticed by some historians,[3] and it is an interesting reflection that in both cases a declining state caused men to long for a simpler and more "natural" life.

Roman Ideas on Value. — In accord with the practical, non-speculative genius of the Romans was their thought concerning value.\ Passing from a régime of customary price, they had, as early as 450 B.C., when the Laws of the Twelve Tables were formulated, left the determination of price to the fluctuations of the market.\ The buyer was given no recourse against the seller except in case of misrepresentation, and Paulus quotes Pedius to the effect that "the prices of things are to be determined neither with reference to affection nor to their utility to single individuals, but prices have a common validity."[4] It was the doctrine of the jurists that each might seek to overreach the other in the matter of price. But as for any analysis of the forces which determined what constitutes "overreaching," or any exact definition of it, there was none.

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[1] *De Re Rustica*, I, xvii, 2; cited by Oliver, *Roman Economic Conditions*, p. 127.

[2] But see Oliver, *Roman Economic Conditions* (University of Toronto, 1907), pp. 21 ff.

[3] E.g., Kautz, above cited, p. 161.

[4] *Ad Legem Aquillam*, Dig., Bk. IX, tit. ii, § 33; Sewall, *Theory of Value before Adam Smith*, p. 6.

As time went on and exchange grew, the concept of a just or true price, *verum pretium,* arose. Thus one of the Emperor Diocletian's rescripts allowed the seller a right of recovery in case of a sale for under half the true price (*verum pretium*).[1] In an edict *De pretiis rerum venalium* (A.D. 301) the same emperor attempted to fix a just price on the basis of customary cost of production.[2] Though these rules could not be enforced, they certainly show some tendency toward introducing ethical considerations,[3] and toward a limitation of the freedom of contract during Rome's later years.

It is to be observed that the importance of wants and utility did not escape recognition, though not as a chief factor. Thus Cicero says, "The only limit to the valuation of such things (bronze statues) is the desire which any one has for them, for it is difficult to set bounds to the price unless you first set bounds to the wish";[4] and Seneca remarks that some things are of greater value than the price which we pay for them. Such a recognition could scarcely have failed to obtain where there was a knowledge of Greek philosophy. It seems too much, however, to say that, after the development of commerce and credit, utility became the basis for exchange value, the judgment of utility depending on the wants of the average normal man.[5]

Industrial and Commercial Regulations. — It is not to be inferred that, because the Roman law stood for private property and freedom of contract, the Roman state did not interfere in economic matters. In times of financial crisis the state established a public bank to supplement the activities of the professional bankers of the Forum,[1] and not a few measures for the protection of debtors were passed. Cicero induced certain Greeks and Romans, who had cornered the food supply in Cilicia, to promise stores to the people; and fines were levied on grain merchants who by hoarding had raised prices. An ædile inspected goods placed on sale in Roman markets, confiscating those in which fraud was found; and at various times the government took measures to prevent foreign competition with Italian producers, to regulate prices of oil, and to prevent the exportation of precious metals. An interesting case, too, is the regulation of traffic in Rome, loaded wagons being forbidden the use of the streets, except during the evening or night, and only those engaged in public building operations could be used between sunrise and the tenth hour.[2] All this was before the close of the Republic, and indicates the recognition in a practical way of the necessity for state participation in industrial matters.

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[1] See Ashley, *English Economic History*, Vol. I, p. 208, note 19.

[2] Mommsen, *Der Maximaltarif des Diokletian* (Berlin, 1893).

[3] Cf. Endemann, W., *Studien in der romanisch-kanonistischen Wirtschafts- u. Rechtslehre*, II, 30.

[4] *De Beneficiis*, Bk. IV, Chap. xxv (Sewall, above cited).

[5] Rost, *Die Wert- und Preistheorie* (Leipzig, 1908), takes this view, p. 26, note 1.

Influence of Roman Thought. — While it must be admitted that, their legal contributions excepted, the Romans added little to the stream of economic thought, their importance as a medium for such thought is great. The mystery of antiquity, the sonorous tongue, the prestige of military and political preeminence all combined to spread the writings of Roman orators, essayists, and philosophers; and with them were disseminated the Stoic philosophy and the ideas of the Greeks. With them, too, went the practical maxims of the people, and incidentally the advice of the father or the meditation of the statesman conveyed ideas of economic significance.

These writings were read, nay, studied, by men of a later day, in Germany, France, and England, whose veneration for them gave them a weight which we can hardly realize. Moreover, the relative development in economic thought of the early moderns was not great, and their economics and ethics were not untangled. Thus it is that this seeming commonplace of Cicero's or that of Seneca's had much greater influence than was warranted by its intrinsic economic worth, and greater than it could have with ourselves. Though the Romans did not directly develop economic theory, a knowledge of their writings is essential to an understanding of the continuity of the history of economic thought.

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[1] Livy, VII, xxi, 8; XXII, lx, 4; XXIII, xxi, 6.

[2] "Lex Julia Municipalis," *Corpus Inscriptiorum Latinarum*, Vol. I, 206: II, 56–61, 66–67; cited by Oliver, *Roman Economic Conditions*, p. 133.

Division of Labor. — To take but a single example, consider the subject of division of labor. Adam Smith first fully developed its economic aspect; but he rested upon Hume and Hutcheson. But Hume's footnotes are full of allusion to Roman writers, and Hutcheson expressly acknowledges his debt to Cicero on this very subject.[1] From this it is not to be inferred that but for Cicero and his Greek predecessors there would have been no division-of-labor doctrine, nor that Cicero understood the full significance of such a doctrine. When, however, an idea becomes part of a system of thought, it gains a significance and richness of content that makes a case like the preceding of some interest.

Summary. — In brief summary, it may be remarked that great service of the Romans to economic thought was the development of jurisprudence as a science, a jurisprudence whose practical spirit supported a great degree of impersonal individualism through its doctrines concerning property, contract, interest, and the like. To this should be added the influence of Stoic philosophy, with its mixture of idealism and materialism.

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[1] *System of Moral Philosophy*, Vol. I, p. 290. Cicero's words are as follows:— "Indeed, the very things that I have called inanimate are produced for the most part by the labor of men, nor could we have them unless handicraft and skill had given their aid, nor could we utilize them except under the management of men. Nor without the labor of man could there be any care of health, or cultivation of the soil, or harvesting and preservation of grain and other products of the ground. Nor could there be the exportation of our superfluous commodities, nor the importation of those in which we are lacking, unless men performed these offices . . . whence, indeed, could houses . . . have been furnished . . . unless society had learned to seek aid in these things from men? . . . Why should I enumerate the multitude of arts without which life could not have been at all? How could the sick be cured, what would be the enjoyment of the healthy, what would be our food or our mode of living, did not so many arts give us their ministries? It is by these things that the civilized life of men is so far removed from the subsistence and mode of living of the beasts. Cities, too, would not have been built. . . . These things have been followed by mildness of disposition and by modesty, and the consequence is that human life is better furnished with what it needs, and that by giving, receiving, and interchanging commodities and conveniences we may have all our wants supplied." (*De Officiis*, Bk. II, Chaps. 3–5.)

As Ingram says, "Their historic mission was military and political, and the national energies were mainly devoted to the public service at home and in the field. . . . As might be expected from the want of speculative originality among the Romans, there is little evidence of serious theoretic inquiry on economic subjects." [1]

It is essential to emphasize their influence in an objective way through institutions, juristic or political, and further to point out that their prestige as classics gives them an adventitious importance.

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[1] *A History of Political Economy* (New York, 1907 ed.), p. 19.

APPENDIX TO CHAPTER V

QUOTATIONS FROM WRITERS ON AGRICULTURE

"After the paterfamilias has come to the villa and performed his devotions to his domestic deity, he ought that same day, if possible, to make a tour of his farm; if not that day, at least the next. When he has considered how his fields should be cultivated, what tasks should be completed, what not, then on the next day he ought to summon the *vilicus*, and inquire what work has been accomplished, what still remains; whether the work is far enough advanced for the season, whether what still remains can be completed, what has been done about the wine, corn, and other products. When he has ascertained this, he ought to inspect the account of the various workmen, and of the working days. . . . When there have been storms, consider the work that could have been performed while it rained; jars ought to have been washed and pitched, the villa cleaned, corn carried away, dung removed, dunghills made, seed cleaned, old ropes repaired, new ones made, and the slaves ought to have patched together their rag-garments and caps for themselves. On holy days old trenches could have been cleaned, the highways paved, the brambles cut, the garden dug, the meadow cleared, twigs bound, thorns rooted up, the spelt pounded, everything put in order. When the slaves have been sick, the ordinary supply of provisions ought not to have been given to them. When he is quite satisfied with his examination, he should give orders for the completion of the work that remains. He should then inspect the accounts of the *vilicus*, money-account and provision-account, the supply of food prepared, the wine-account, the oil-account, what has been sold, what used, what remains, what of this is for sale. Let there be good security for what is owing. As to what remains, he should see that it tallies. He should buy what is wanting for the year, have the surpluses sold, let out the necessary contracts. He should give orders concerning the works he would have completed, and the things he is inclined to let, and leave his order in writing. He should carefully inspect his flocks, make his sales, sell the superfluous oil, wine, and corn, if they are giving a good price, sell the old oxen, the refuse of the cattle and sheep, wool, hides, the old carts, old iron tools, and old and diseased slaves. Whatever is superfluous he ought to sell: 'A farmer should sell, not buy.'" (CATO, *De Re Rustica*, II.)

Of the *vilicus* Cato says: "He should maintain good discipline, attend to the observance of holy days, keep his hands off the property of others, faithfully protect his own, preside over disputes among the slaves, punish with discretion those guilty of a delinquency, provide against ill befalling the household, against sickness, against hunger. If he keeps the slaves busy with work it will be easier for him to keep them out of mischief and out of other people's affairs. . . . He must extend loans to none without his master's orders, and must exact payment from his master's debtors. He must lend no one seed for sowing or provisions or spelt or wine or oil. Let him have two or three households from which he may borrow, or to whom he may lend articles — let this be the limit. He must often reckon his accounts with his master. He must not use the same labourer, hired servant, or cultivator longer than a day. He must not desire to sell anything without his master's knowledge, or to conceal anything from his master." (Cato, *De Re Rustica*, V, 1–5.)

"As for those articles which can be raised on the farm or manufactured by the servants none of these should be bought. Of such a nature are nearly all those utensils in the manufacture of which you use osiers and other materials at hand in the country; for example, baskets, broom-baskets, threshing-sledges, winnowing-vanes, hoes; so too those in the making of which are employed hemp, linen, rushes, palms, bulrushes, as ropes, cords, coverings. But in the case of things which you cannot produce on the farm make your purchases with a view to their usefulness rather than ornament, and then their cost will not eat up their profit. This will be especially the case if you get them where they can be obtained good in quality, close at hand, and cheap in price." (Varro, *De Re Rustica*, I, XXII, 1, 2.)

II. MEDIEVAL ECONOMIC THOUGHT

CHAPTER VI

THE MIDDLE AGES [1]

The Period Defined. — There is a certain rather ill-defined period in the world's history which is commonly known as the Middle Ages. Most writers agree in placing the beginning of this period at the fall of the Roman Empire in 476, but its ending is not so clear. Dr. Ingram [2] and others would bring it to a close with the year 1300, and it may be agreed that the Middle Ages reached a climax at about that time. But it by no means follows that the years of decline and break-up of medieval institutions which ensued, constituted the beginning of things modern. Ingram himself says that the movements of his first modern phase (1300–1500) "can scarcely be said to find an echo in any contemporary economic literature."

It seems more nearly true to regard the years about 1500 as marking the end of medieval times. By 1300 the transition was not complete. Not till toward the close of the fifteenth century did Humanism mark the rise of new tendencies in thought. At the same time the religious world was on the eve of its great Reformation; while in the mixed field of politics and economics the beginning of modern nation-building may be discerned. More objectively, there were such geographical discoveries as that of America and the water route to India (1498); and the extended use of such agents of civilization as the mariners' compass and gunpowder began during the same period. The significance of the influx of silver which followed the discovery of America has often been noted and its importance in bringing about the exchange economy of modern times commented upon; but American mines were not opened until the sixteenth century.

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[1] See O'Brien, *Essay on Medieval Economic Teaching;* Gray, *The Development of Economic Doctrine,* Chap. II; Monroe (Ed.), *Early Economic Thought;* Sewall, *Theory of Value before Adam Smith,* and references in following footnotes.

[2] Following Comte.

In a word, the Middle-Age period does not close with Nicole Oresme (d. 1382), but with Gabriel Biel (d. 1495), his disciple, who is sometimes called "the last of the schoolmen."

If further proof were needed, it might be observed that Feudalism, a preëminently medieval institution, did not generally begin to lose its power until after 1500, the period during which it really represented the political organization of French society, for example, being that lying between the years numbered 1300 and 1500.[1] It was in the early sixteenth century, too, that the English government gave the death blow to craft gilds, another medieval institution.

On large lines, and from the point of view of systems of thought rather than systems of industry, the Middle Ages may with profit be divided into two periods. From 400 down to 1200, or shortly thereafter, constitutes the first. During these years Christian theology opposed Roman institutions, and Germanic customs were superposed, until, through action and reaction, all were blended. This was the reconstruction; it was the "stormy struggle" to found a new ecclesiastical and civil system. From 1200 on to 1500 the world of thought settled to its level. Feudalism and scholasticism, the cornerstones of medievalism, emerged and were dominant. The latter, springing from the fusion of Aristotle's philosophy with Christian theology, was formulated by Thomas Aquinas, who may be said to mark the turning point between the sub-periods.[2]

Early Germanic Contributions to Economic Thought. — Relatively little is to be said about the economic ideas of the early Germanic tribes. Their contribution was rather a new point of view, given expression in particular customs. This is not the place to discuss the mark, the three-field system, and all the interesting phenomena of their industrial life. It will suffice to recall the fact that originally the social and economic unit was the village community (*Genossenschaft*), a virtually self-sufficient group of households, democratic and similar in wealth. The community came before the individual, and within it the idea of brotherhood was strong. It followed that exchange for gain was hardly tolerated within the community, but a common value was placed upon such things as were exchanged, and even exchanges with other groups were regulated. There was no money economy.

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[1] Esmein, *Cours élémentaire d'histoire du droit français.*

[2] The periods suggested correspond rather closely to those in industrial history. Sometime during the twelfth or thirteenth centuries in England, and to a less extent in France and Germany, a town economy with division of occupations, inter-municipal trade, and money, largely replaced an independent domestic economy in which those characteristics were more or less lacking, and land was the chief basis of social and economic life.

The ideas and customs of the Germanic tribes sharply differentiate them from the Romans. The latter based their law upon individual property rights; the former emphasized the community, — though a large degree of democracy gave room for a broad individualism. In agriculture, for example, the members of the village community, despite individual ownership of arable land, had to do their work at the same time and in the same way.

Accordingly, with the Romans there was a sharp distinction between private and public rights, but in the case of the Teutons these rights were mutually determining and faded into one another. More specifically, Roman law made property rights rather absolute and rigid, while by Germanic custom these rights were relative and changing. For example, the *Genossenschaften* had several different kinds of landed property, perhaps these four: dwelling places, gardens, arable lands, waste lands. In the first two, a large degree of private property was recognized; but the fields, with their changing strips, were subject to the plans of the community, and the waste land, or "commons," as its name implies, was the property of no individual. Thus property rights had a different extent according to the nature of the object involved.

A noteworthy characteristic was the emphasis put by these peoples upon personal rights. Their laws seem to indicate that they were more concerned about such than about property rights. On the other hand, and almost paradoxically, personal rights depended largely upon landed property, land being the chief factor in their industrial stage.

The Influence of Christianity and the Church. — If the Roman component be taken for granted, Christianity and the Church may be considered next as perhaps the chief factors in determining medieval thought. It is necessary to keep these two ideas separate, for few will deny that Christianity as a religion is quite distinct from the various institutions or churches which profess it. Those principles of Christian doctrine which have any direct economic significance follow.

(1) Christianity taught a brotherhood which extended beyond community or nation, embracing all classes and races.[1] It was cosmopolitan in spirit.

(2) The Church, in accordance with the spirit of Christianity, taught the natural equality of rights among men. Men may be unequal, but only as brothers are. The ancients, as already seen, believed that men were different by nature: slavery, like castes, Levites, and "guardians," was natural, and corresponded to some inherent baseness.

(3) Accordingly, slavery was condemned, wholly or in part, the least radical teaching being that the slaves of the laity should be freed when Christianized.

(4) And closely connected with the doctrine of brotherhood and equal rights was the idea of a natural community of property.[2] Originally, and according to the law of nature, men owned all goods in common.

(5) One of Christianity's teachings, which was notably at odds with the ideas of antiquity, was that concerning the dignity of labor. This it upheld, though not without some ecclesiastical adulteration, and the ideal became a force working for a greater recognition of those who ate their bread in the sweat of their faces.[3] The various Biblical maxims concerning the merit

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[1] "And if a poor man have a quarrel with a rich man, sustain the poor rather than the rich, until the truth is made clear, and when you know the truth, do justice to them." (Advice of St. Louis to his son.)

[2] See article by H. H. Swain in *Bibliotheca Sacra*, October, 1897, on this point.

[3] *Gen.* iii. 19.

of industry were of no small weight to the men of this credulous time.

(6) Charity and almsgiving, too, were among the cardinal virtues. Not only the writings of the Old Testament, but the words and spirit of Christianity, taught the duty of giving aid to the poor. St. Louis advises his son thus: "Dear son, have a tender and pitiful heart for the poor, and for all those whom you believe to be in misery of heart or body, and according to your ability comfort and aid them with some alms." This quotation, however, suggests two limitations upon the charity of medieval churchmen: their alms were in theory to be given only to those recognized as being in real need, and then were to be in proportion to the donor's means — as an offset to inequalities in wealth. Charity was considered a duty, and represented both a recognition of social inequality and the trusteeship of the rich.

(7) Finally, Christianity was a force for purifying and perpetuating the family and family life.

Thus the Christian religion tended to introduce elements which were deficient in the philosophy of Roman jurisprudence. The personality of man was emphasized. With the increased recognition of human worth came the introduction of moral and humanitarian ideas which placed new limitations (duties) upon individualism, while increasing the rights of many individuals.

In fact, one cannot but be impressed with the idea that, on the whole, Christianity and Germanic customs worked hand in hand. Their fidelity, their relative freedom, their greater equality, their emphasis of the personal element, all made the Teutonic folks a ready medium for the leaven of the new religion. Both of these factors in medieval thought tended to emphasize "duties" as related to "rights" — the responsibilities of power. It should ever be remembered that the serf had certain rights which represented the *duties* of his lord. This is an important aspect of medieval thought.

As already suggested, the foregoing principles of Christianity were considerably modified or given a special meaning in their practical application by the Church. To mention but an instance or two: the "natural law" of equality was admitted to be modified on grounds of expediency so as to permit inequality both in property and in status. The idea of brotherhood was reconciled with inequality in wealth by teaching that charity is a duty, and by preaching that the rich should regard themselves as trustees for their brother men.

At the same time, it must be noted that charity was too commonly regarded as an end, as a pious thing, rather than as a means for benefiting society or the poor. So, too, with manual labor: it was regarded rather as a form of discipline for the attainment of salvation than as a means for producing wealth. Pride was not to be taken in the craft, and the main interest was not to be in the product.

As a rule, the general economic development was not favorable to the complete advancement from slavery, and the Church made room for it on grounds of expediency. Serfdom can scarcely have disappeared in towns by the year 1000, while agricultural serfdom lingered on into the nineteenth century. Still there was the tendency toward freedom.

Prior to the thirteenth century the Church fathers concerned themselves but little about economic matters.[1] For one thing a very simple independent domestic economy prevailed; and, on the other hand, purely religious ideas were in control. Consequently, one finds little but moral dissertation concerning the evils of luxury, and the like. Among the most noteworthy economic ideas were those concerning the desirability of wealth, value, and the relative merits of different forms of industry. In these there is little new. Agriculture was praised; manufacture did not displease God; but trade could not be pleasing to the Deity. Material wealth was dangerous to spiritual welfare, though it was permissible to the laity if used for the good of their fellow men. As to value, the recognition of labor was preparing the way for a cost theory based on the labor element. The general notion appears to have been that value is absolute and independent of price. Accordingly, exchanges were looked upon as just or unjust in proportion to the equality of the absolute values; and usury was forbidden to churchmen on the ground that in the taking of interest a greater value would be exacted than that given, which would result in injustice to the borrower.

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[1] Cf. above, p. 34.

But as early as the eleventh century progress began. With the growth of monasteries, towns, handicraft, and commerce, and the increasing use of money, new phenomena were presented; while in the twelfth century the first Latin translation of Aristotle's *Politics* found its way into western Europe. The latter fact marks an epoch in medieval thought.

Scholasticism and Canon Law.[1] — Neither Christianity nor the Church, but part of each, with an admixture of the philosophy of Aristotle, was scholasticism. It was the system of thought which came to dominate ecclesiastics during medieval times; it was the scholarship of the Middle Ages. In it the theological element was dominant, and no advance in knowledge was considered established until the new idea was fitted into its niche in the structure whose foundation was religious. It cannot be called a science, for it did not seek to explain phenomena so much as to apply certain absolute rules of conduct to existing conditions. The last word was said with a citation from the Bible, one from the Church fathers, and now and then one from profane history.

It is not improbable that the progress made by medieval scholars in economic thought has often been underestimated, largely, no doubt, because their methods and conclusions were so different from those now dominant. It was Roscher's opinion that the scholastics, and above all Scotus, made more progress than is commonly believed, though only in certain special forms. Most valuable is that part of their work devoted to the sacrament, especially the sacrament of confession. Here were investigated the conditions which must precede the absolution of the penitent sinner and how far he must make good his wrong; and that led, in the case of sins which involved economy, to an inquiry into the nature of economic institutions. The conclusions reached will be discussed in a moment. The difficulty was that economics was not made a distinct line of thought. The monks knew little outside of Aristotle's writings, and Aristotle wrote no books on political economy.[1]

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[1] For a valuable analysis of religious thought in the sixteenth and seventeenth centuries see H. M. Robertson, *Aspects of the Rise of Economic Individualism* (1933); also M. Beer, *Early British Economics*, 1938.

Thomas Aquinas has been called the prince of scholastics. He it was who with infinite pains and ingenuity strove to weld the teachings of the Bible and of Aristotle into a harmonious body of thought. And, in the uncritical judgment of his contemporaries, he succeeded. One result of his attempt was the celebrated classification of laws into eternal, natural, human, and divine. The first is the controlling plan of the universe as conceived by God; that part of it which can be grasped by man and which enables him to distinguish good and evil is natural law; while human or customary law consists of the enactments of earthly powers. Divine law is that part of the eternal law revealed in the holy writings. Human law should be based upon natural law. It fell into two parts: civil law (Roman) and canon law (Church). Canon law, or the *Corpus Juris Canonici*, was coördinated and given a systematic form about the middle of the twelfth century by the monk Gratian of Bologna. It was drawn from a mass of ecclesiastical legislation and decisions, thus containing elements of Christian doctrine, Aristotelian philosophy, and Roman law. It expressed the judgment of orthodox churchmen concerning human relations, and so contained economic ideas.

The tendency of scholasticism was on the whole opposed both to individualism and to the emphasis of the human personality as the basis for economic decisions. It tended to subordinate the individual to the institution, and to consider man as subject to "natural" laws. Thus, on the one hand, it tended to limit that reference to individual choices which was to become the basis of economic science; while, on the other hand, it kept alive and emphasized the concept of social uniformities and the dominance of abstract "laws" which later contributed to the idea of that science.

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[1] This explanation is given by Gasser, *Introduction to the Economic, Political and Kameralistic Sciences* (Halle, 1729), as a reason why economic subjects had not been taught in the German universities. A work under that title is sometimes attributed to Aristotle, but even if he wrote it, it does not deal with economics proper in any distinct way.

Value and Just Price. — Passing over ideas concerning wealth and industry, which were substantially those mentioned above, one reaches the heart of their economic thought in the doctrine of *justum pretium.* This doctrine rested upon their notion of value. This concerned exchange value, for exchanges had become more important than in Aristotle's day. But the institutions of an independent domestic economy, and the ideas of production for use, were sufficiently prevalent — and competition was sufficiently absent — to make freely determined market values seem "unnatural." Labor was the chief factor in production; the gild master worked at his trade; there was little capital. So the worth of a thing tended to be judged by the amount of labor required to produce it. Briefly stated, the doctrine of "just price" was that every commodity has some one true value which is absolute, and is to be determined and be made objective on the basis of the common estimation of the cost of production, which usually covers labor.

The words, "is to be determined," are used deliberately; for the doctrines of the scholastics are only to be understood when considered as ethical, — as laying down what should be, rather than scientific conclusions as to what *is.* To sell a thing for "more than it is worth," was regarded as immoral.

As formulated by Albertus Magnus (1193–1280) and Thomas Aquinas (1227 or 1225–1274), the theory was that value should equal the expenditure of labor and other costs. Thus, according to Aquinas, a man might lawfully charge more than he had paid "either because he has improved the article in some respect, or because the price of the article has been changed on account of difference of place or time, or on account of the danger to which he exposes himself in transferring the article from place to place, or in causing it to be transferred."[1] This generalization, however, was qualified to the extent that only those costs which were incurred in producing things which satisfied normal or natural wants were determining.[2] Furthermore, the labor element was weighted according to the social rank of the laborer. This involved the important idea of "status" and fixed rules as to the standard of life for each status, in order that the cost of production — as it was conceived — could be determined.

The value thus fixed was not necessarily expressed in market price, and was independent of the estimate of buyer or seller. It was a question of justice,[3] and it was the duty of the law to step in and fix the price according to the above principles. In short, "just price" was akin to our concept of "fair value," and, as opposed to objectively determined market value, it involved a process of "valuation" or "price fixing." It was quite in harmony with this conception that Charlemagne, at an earlier time, ordained "that no man, whether ecclesiastic or layman, shall, either in time of abundance, or in time of scarcity, sell provisions higher than the price recently fixed per bushel."[4]

With the rise of towns and money economy, this notion of value began to be modified, though it dominated the whole period and beyond. Aquinas gave some consideration to utility and to the amount offered for sale, or supply. Buridan (1300–1358) went farther and, following Aristotle, stated that the measure of value is to be found in the satisfaction of wants: the greater the need, the higher the value. And Biel (died 1495), while standing for a necessary equality in value of goods exchanged, bases it upon their utility for human ends.[5] But when all has been said, the conclusion is that it is broadly true that a conception of value as absolute and based on cost prevailed during the Middle Ages.

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[1] Quaestio lxxvii, art. iv, *Opera*, XIX, p. 181. Quoted by Sewall, *Theory of Value before Adam Smith*, p. 18. For translation of this and other discussions see Monroe (Ed.), *Early Economic Thought.*

[2] Cf. Aristotle's teaching, above, p. 65.

[3] ". . . if either the price exceeds the value, or, conversely, the value exceeds the price of the thing, the balance of justice is destroyed," wrote Thomas Aquinas.

[4] Blanqui, *History of Political Economy*, p. 112.

[5] Contzen, *Geschichte der volkswirtschaftlichen Literatur im Mittelalter.*

Value of Money; Usury. — How did such an idea of value work when applied to money? The answer to this question brings up the well-known doctrine of usury. The term was used to cover what we designate as interest, and, in a broader sense, to include any price in excess of the *justum pretium: qui plus quam dederit accipit, usuras expetit* — he who receives more than he gives demands usury. At first (325 A.D.) usury was forbidden the clergy only, but before the close of the twelfth century the prohibition was extended to the laity. As late as 1311 it was declared absolutely illegal. The broad simple ground for this action was the belief that to take interest for a loan of money was, like charging more than the just price, unjust. A scholastic brief against usury might be drawn as follows: —

(1) The holy writ forbids it: The Mosaic law prohibits usury-taking from a brother; Christ said, "Lend, hoping for nothing again." (*Luke* vi, 35.)

(2) Aristotle says money is barren and cannot breed money, therefore, to demand usury for its use is unjust.

(3) It follows from the above point that to pay for money is to pay for time; but time is common property and belongs to God.

(4) Money is a *res fungibilis*, or "consumptible," according to the civil law. As such it has no use distinct from itself; its use cannot be separated from the ownership of it, and a loan must amount to a sale. Therefore, to lend money is to give up ownership of it, and to ask a payment for the use of that which is sold is unjust.[1]

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[1] The reasoning of Aquinas on this point appears in the following quotation: "To take usury for a loan of money is in itself unjust; for it is to sell what does not exist, which is an inequality, and, therefore, an injustice. To understand this it must be known that there are some things whose use consists in the consuming of them, as when we consume wine. . . . In articles of this kind [consumptibles], therefore, the use of the thing must not be reckoned separately from the thing itself; he who is given the use is thereby given the thing. And accordingly in lending a thing of this kind, all the rights of ownership are handed over. If

As in the case of the general concept of value, the development of industry and exchange wrought a gradual modification of the doctrine of usury or value of money. Aquinas and his brother scholastics recognized exceptions: for example, where a loss was incurred by a loan (*damnum emergens*) or a profit was missed (*lucrum cessans*) a corresponding sum might be demanded of the borrower. Then other openings were made. A buyer on credit was not prohibited from paying more than the cash price; discounts were allowed on bills of exchange; money combined with labor, as in partnerships, was called productive;[1] Jews and Lombards, being damned anyhow, were permitted to take usury; and, in the fifteenth century, the *montes pietatis*[2] were allowed to receive interest. Late in the period, banking houses such as the Fuggers were associated with the financial operations of the Holy See, and it thus became difficult for the Church to frown upon interest on bank deposits.

The medieval idea of usury could not have long existed in a "money economy." The social organizations with which Biblical writers, Aristotle, and the schoolmen alike were associated, were non-capitalistic, and largely self-sufficient. They were not exchange economies. The political counterpart of this industrial condition was a predominance of clan or family feeling, a feeling

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therefore a man wanted to sell wine and the use of the wine apart from one another, he would be either selling the same thing twice (meaning that the use *is* the wine), or would be selling what did not exist. Wherefore he would be manifestly committing injustice and sinning. For the same reason, he would commit injustice who lent wine or corn, seeking for himself *two* rewards, the restitution of an equal amount of the article and also a payment for its use, called usury."

"But money, as Aristotle says, . . . has been devised for the making of exchanges. So the first and chief use of money is its consumption or spending. Wherefore it is in itself wrong to receive (besides the return of the money itself) a price for the *use* of the money." (Quoted by Ashley, *Introduction to English Economic History and Theory*, Vol. I, p. 153.)

[1] Gabriel Biel, Professor of Theology at Tübingen, 1485, held that in deeds of partnership any rate of interest was allowable according to the gains of the capital as invested by the debtor, only the creditor must share any loss. Also, if one partner put in money and another contributed labor, the labor might be evaluated in terms of money, and the profits of the business be shared *pro rata*. See Contzen, *Geschich. d. volkswirts. Lit. im Mittelalter*, index under Gabriel Biel; and Roscher, *Geschichte der Nationalökonomik in Deutschland*, pp. 22 ff.

[2] Pawn shops.

which appears in the gild, and even in the medieval municipality. This explains to a large extent the general condemnation of interest-taking. Loans at interest generally involve a rather abstract or impersonal relation between the parties, such as became common with the establishment of money economy. Even today the purely business relation is apt to become unsatisfactory when existing among relatives or persons belonging to the same social organization, and the condemnation of usury was natural when most of a man's dealings were with such persons.

Economic Functions of the State. — Another group of ideas held by the scholastics concerned the economic functions of the state. In general the independent domestic economy idea was applied to a large group, or, in other words, the state was regarded as a sort of great private or domainal economy. The position of taxation illustrates the situation. In the twelfth and thirteenth centuries, at least, the office of the ruler seems to have been regarded as private property. His revenues came from his estates and certain prerogatives,[1] and there was no system of taxation in the modern sense, for that represents more modern economic thought.

The particular functions proper to government were the maintenance of population and provision for the poor, the establishment of safe and free roads — a Roman conception backed by citations from the Bible, a system of weights and measures, and a special coinage. The argument for the maintenance of weights and measures was that it would decrease quarrels and litigation, and that the Bible says, "God has ordered all things by number, weight and measure." [2]

The duty of the medieval ruler to provide an exact and unchanging coinage was constantly emphasized. One reason advanced by Aquinas why a prince should provide money was that he could thus get food for his subjects in time of war. Virtually without exception the right of coinage and monetary control was possessed by him, and many laws were passed to prevent counterfeiting and clipping. The exportation of coin, as also the circulation of foreign coins, was frequently forbidden. This regulation of money was a logical concomitant of the doctrine of just price: the supply of money being small, relatively slight changes in its quantity might affect prices, and the difficulties of transport made readjustments slow.[1]

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[1] See below, p. 161.

[2] *Book of Wisdom*, ix.

It is not to be supposed, however, that the medieval ruler was generally efficient and socially minded, or that the various laws referred to were effective. Public administration was often corrupt and inefficient, and had little power to enforce its rules. Weights and measures as well as coinage, were actually in a chaotic condition. Under Feudalism and towns, the economic life of the state was disintegrated. Transportation and exchange were burdened with tolls and duties. Each town sought to restrict and control its market ("staple") for the benefit of its own trade.

Monasteries. — Monasteries might be treated as a distinct factor in the life and thought of the medieval period. They were Christian industrial colonies influencing men in many ways, both by precept and example.[2] Objectively, the manual activities of the monks improved agriculture, disseminated industrial arts, and stimulated commerce. When a surplus was produced or a new supply of raw material was needed, exchange arose, and the principles which should govern the *negociator ecclesiæ* in economic relations with the outside world were carefully formulated. Their chief service was to "diffuse a better appreciation of the duty and dignity of labor," though after the tenth century this service waned.

The Economic Thought of Medieval Townsmen.[3] — Taking it for granted that the reader is familiar with the picturesque phenomena of medieval towns, with their gilds and market places, it remains to point out the bearing of various town and gild regulations upon economic thought. There was always a large element of monopoly present and competition as we know it was unthought of. Foreigners were admitted to the trade of the town, but only under controlling restrictions. Thus they were subjected to tolls, were under surveillance, could not sell at retail save under great restriction, and could not deal with other foreigners unless at fairs or on certain days. In these regulations, also, appears the common hostility to strangers.

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[1] See Ashley, *Eng. Econ. Hist.*, Vol. I, p. 173.

[2] See Cunningham, *Western Civilization in Its Economic Aspects*, pp. 35–40.

[3] Especially in England.

But this monopoly was a public one and designed to be in the interest of the community; trade was regarded as a public opportunity. The idea of equality and of public benefit appears in such common regulations as that sales were not to begin before a certain hour, that unsold goods could not be withdrawn until a certain time, and that raw materials — as tallow, for example — must not be sold to outsiders.

The universal prohibition of forestalling, regrating, and engrossing illustrate the above point, and are also connected with the idea of a just price. Indeed, the price of the town's manufactures was regulated; and that of the trader's merchandise was fixed within certain limits, though it came to be allowed a maximum and minimum within which it might play.

And this suggests the minute regulation of trade and industry, largely through the agency of gilds, a regulation which characterized the whole economy, and which, again, was commonly in the interest of the consumer, being notably so in the case of foodstuffs.

Interesting features of town economy were its communal property and undertakings. Thus a common town pasture was frequent; many towns got control of the seignioral mill (and the burghers were required to patronize such mills, the proceeds often going to decrease taxes). Bakeries, ovens, market places, and stalls might be added to the list. Then, too, in times of scarcity it was considered the duty of the town government to furnish grain. It sometimes made common bargains with foreign merchants for the materials needed by its artisans. Public works were carried on by the compulsory labor of the community.

The gilds, which were more or less closely associated with town government, serve to emphasize much the same line of thought. They were associations of merchants or craftsmen for the mutual benefit of their members, having as their ends protection, monopoly of the trade or craft, good workmanship, and fraternal and religious benefits. These associations served to train men in business ethics, to develop personal relationships, and to harmonize the interests of producer and consumer. And the craft gilds developed skill, protected the artisan, and increased the dignity and worth of labor. The ideas of just price, of regulation of quality and quantity of output, and of wages and conditions of employment, characterize their dealings.

In view of the exaggeration in the old idea concerning the freedom and equality in towns, it remains to be said that this idea is only relatively true. Depending upon the origin of the town,[1] almost from the beginning there were three or four distinct classes which successively dominated. A considerable number of inhabitants did not have the franchise, and the craft gilds, even, were in part monopolies of the masters (aldermen, wardens, commonalty) against the serving men.

As compared with rural life, however, there was a nearer approach to freedom which was quite marked in the earlier times in England.

General Significance of the Period. — The general significance of the Middle Ages as a period in the evolution of economic thought is rather difficult to state by reason of its complexity. In a sense, its negative aspect is large. While the chasm left by the downfall of Rome may have been exaggerated, yet civilization, as it had been, was in ruins.

But it had its positive characteristics, and the Middle Ages constitute, first, a period of adjustment and fusing; secondly, one of transitions. During its centuries, Roman institutions, standing for a narrow individualism and, on the whole, for a materialistic philosophy; Christian religion, teaching the brotherhood of man and idealism; early Germanic customs, showing a broad and democratic individualism and leaning toward idealism; Aristotle's philosophy, emphasizing the common good and arguing for some degree of common use of property, with a correspondingly limited individualism,[1] — all these were to be combined and fused. This was more or less consciously the work of the scholastics, who strove to formulate on an impersonal basis a consistent body of logical rules concerning the rights and duties of the classes of men, and the forms and functions of government. Thus Thomas Aquinas labored to adapt Aristotle while he assailed Rome; and one Nicholas von Cusa, while deeply versed in the contemporary learning of the Occident, turned his attention to the East; he sought to reunite the Greek and Latin churches, and studied the holy book of the Mohammedans.[2]

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[1] In towns which grew up under the protection of some clerical noble, for example, all the aids, etc., exacted on a manor might be rendered by the townsmen.

As a transitional period it was during the Middle Ages that, objectively, national economy replaced independent domestic economy; that commerce and manufactures encroached upon the sole rule of agriculture; and that slavery was gradually abandoned for serfdom and free labor.

But it is the world of thought which is of interest here. In it one finds a transition from the materialism of later paganism to the modified idealism of Christianity. At the same time the individualism of the Romans was succeeded by the idea of a society broader even than the clan, as town life developed inside the domainal state, and the dawn of the eighteenth-century nation approached. We pass from systems of thought which postulate a natural inequality among men, and slavery, to ideals of brotherhood and freedom. The Church, too, became more dissociated, formally at least, first from politics, then from industry, allowing the separate treatment of economics which has been achieved in modern times. An economy in which land was regarded as the basis began the great transition to one in which personal relations dominated. In one, industry in manufactures and trading was despised; in the other, it was fostered. In the one, money was imperfectly understood and men generally condemned its accumulation; in the other, it was better understood, and probably came to be over-appreciated. Between these rather opposite views lay the Middle Ages.

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[1] See above, pp. 61 f. Aristotle's argument against communism in the ownership of property is deservedly a classic, as has already been stated.

[2] Stumpf, *The Political Ideas of N. v. Cusa* (1865), quoted by Contzen, *Geschich. d. volkswirts. Lit. im Mittelalter*, p. 65.

During this great transition one notes that the idea of protection by authority was strong. It appears in the Church and Christianity, in Feudalism and in the towns and gilds; custom, regulation, and legal monopoly, are met everywhere. "Authority" and "status" are two words which must be used frequently in describing medieval thoughts and institutions. The whole economic philosophy of the Middle Ages might be summed up in the doctrine of just price, which aimed to protect buyer and borrower from exploitation by subjecting economic motives to ethical appraisal under a sort of system of "rate regulation." Such regulation was directed toward enforcing ideals of duty, for the most part formulated and enforced by religious authority, but influenced by racial or local custom and occasional political upheavals.

Within the rigidities of custom and such institutions as church, manor, and gild, there were preserved the seeds of individual freedom, which in conjunction with the idea of social order and the reign of law, were to develop into a social science. In a period of turmoil among such great opposing systems of thought, and classes and races of men, before the rise of nations, it was well that the idea of protection was strong.

But for further ideas let the reader, if interested, compare the chapter which precedes this with the two which follow.

CHAPTER VII

MERCANTILISM[1]

That ~~period which may be called the~~ Middle Ages was succeeded by two or three centuries which, as it were, looked forward toward modern systems of industry and thought. The old garments of "natural" economy, feudalism, and scholasticism were not entirely cast off, and medieval thought and institutions both existed and had influence, at least until late in the eighteenth century. But great changes were being worked out, and Mercantilists opposed medievalism, and sought to reconstruct economic life according to a more rational scheme. The thought of the period now to be considered stands in a relation to us different from that of the theories of the ancient world and of the Middle Ages, inasmuch as it was the immediate predecessor of a real school of political economy, the Physiocratic system. The economic problems of this period, notably money and public finance, were much more similar to those of later times, and naturally the economic thought seems to have more bearing upon economic science. Through Adam Smith and his immediate predecessors, for example, it has exercised a direct and practical influence upon the economic speculation and policy of English-speaking peoples down to the present day.

Preliminary Definitions of Period and Doctrines. — The economic ideas, and the corresponding policies, characteristic of men of this first post-medieval period, have been variously styled Mercantile System, Colbertism, Restrictive System, Commercial System, and Mercantilism. As they do not properly form a system and do not belong to any one man or fall under one central economic idea, Mercantilism is preferable. Mercantilism comprises the economic views which prevailed among European statesmen from the sixteenth to the latter part of the eighteenth century. As will appear, such views largely concerned commerce, the idea prevailing that gains through international trade are the principal factor in promoting national power. These views involved much restriction. But these aspects tell only part of the story.

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[1] For general references, see p. 145.

"Political Arithmetic" was a phrase much used by the Mercantilists with reference to their attempts at the more exact solution of the economic problems with which they dealt. This kind of arithmetic they defined as "the art of reasoning by figures, upon things relating to the government."[1] Thus the political aspect is to be given great weight. And, on the other hand, the work of these men as statisticians is to be remembered.

It is difficult to tell just when Mercantilism came to be the guiding principle of state policy, or when its sway ended. The truth is that the ideas which are most characteristic of the Mercantilists have always existed to a greater or less extent. From early times, various cities, and notably the city states of Italy, adopted Mercantilist policies. The Florentine, Machiavelli (1469–1527), and the Frenchman, Bodin (1530–1596),[2] in their advocacy of strong central government as a means of national well-being, were in line with the trend toward Mercantilism. Travers Twiss, however, dates the practice of Mercantilism from the accession of Charles V to the throne of Spain in 1516; for that monarch at once initiated retaliatory measures against the commercial monopoly of Venice. Be that as it may, the date corresponds well enough with the growth of money economy and the rise of nations, — the two phenomena which formed the basis of Mercantilism.

Mercantilism, as a doctrine, was first systematically developed in 1613 by an Italian writer, Serra. In that year his book, *A Brief Treatise on the Causes which make Gold and Silver abound in Kingdoms where there are no Mines*, was published.[3]

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[1] Davenant, *Use of Political Arithmetic.*

[2] See Monroe (Ed.), *Early Economic Thought*, for English translation, and biographical note. Bodin wrote of conditions affecting the supply of gold and silver, which, he says, "is the wealth of a country."

[3] *Ibid.*

In the seventeenth century the most numerous and characteristic Mercantilist writings are found. Then, with the Industrial Revolution and growing political freedom, governments began to abandon Mercantilism in the second half of the eighteenth century.

So much for a preliminary definition of Mercantilism and the Mercantilist period. What, then, were the phenomena and the problems that gave rise to them?

Factors Causing and Shaping Mercantilism. — In order to understand Mercantilism, one must consider many social and economic factors, some of which may at first seem quite remote.

The More Remote and Intangible Factors. — About the beginning of the sixteenth century, there were several more or less remote causes leading to developments in the field of political economy, such as the religious and intellectual awakening of the time.

The Reformation and Protestantism, which we associate with Erasmus and Luther, tended toward individualism and a concept of personal freedom and responsibility, and thus aided the development of property and contract rights that were essential to commerce and the system of free exchange which economics was to assume.[1] At the same time, a strong state was accepted by Protestant thought, and it was encouraged by the decline of Feudalism and the Church, the economies of which were combined in a political (national) economy! (Oliver Cromwell was a Protestant, and his "Navigation Acts" are famous.)

As the Church lost its position as the dominant factor — and particularly after Henry VIII seized church authority — room was made for a more rational concept of the state and of social institutions in general; and, while talk of "divine rights" continued, men began to raise questions as to the basis of authority, and became prepared to reason about economic life.

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[1] Cf. Weber, M., *The Protestant Ethic and the Spirit of Capitalism*, 1930; Robertson, H. M., *Aspects of the Rise of Economic Individualism*, 1933; Tawney, R. H., *Religion and the Rise of Capitalism*, 1926.

Even more significant than the Reformation, are the Renaissance, and the "Humanism" which characterized it. Indeed, these were in strong reaction against medievalism. The essence of Humanism lies in the fact that it centered attention upon the well-being of man on this earth, and made human happiness and culture the immediate goal. It was materialistic at bottom, and tended toward an emphasis of the material basis of happiness. This development came with a revival of the nonreligious study of Aristotle and Plato; and their doctrines of the state, the relation of the individual thereto, and division of labor, have already been stated. Humanism thus worked for nationalism and a strong ruler. But there was in it the idea of the rights of the individual—the idea of the state as a means to the general welfare. In fact, within Humanism, we find the seeds of individualism, and of the concept of "natural law" (e.g., in Hobbes and Grotius) which were in time to bear fruit in the French Revolution and in Classical economics.

A symptom of the times was the publication of Sir Thomas More's *Utopia* in 1516. This work expresses both the Renaissance spirit of cultural self-development in accord with Greek thought, and also the Christian spirit of democratic equality. In suggesting a six-hour day, everybody working, and limited property rights, it was not in accord with the times. Indeed, "Utopias" are to be considered in part as protests arising in periods of social crisis and depression. But it showed that men were thinking about problems of government and economic life, and that the common welfare of the people was not an unknown concept.[1]

Immediate Factors.—The most immediate factors which shaped Mercantilism, however, were the political and economic developments which began toward the close of the fifteenth century. All of these found expression in the rise of nations. The central fact concerning the economic factors was the transition to an *exchange economy.* A characteristic feature of ancient and medieval times was the prevalence of "independent domestic economy" with ideals of local self-sufficiency and little exchange. Naturally, too, manufactures were limited and agriculture had a greater relative importance than is now the case. Without attempting a complete statement, it will be remembered that all this was changing at about the time now under consideration. Developing *pari passu,* there came the beginning of a manufacturing economy known as the "domestic system," a growth of commerce, both internal — among cities of the same country — and foreign, and the extended use of money. By Queen Elizabeth's time England was exporting woolens instead of wool. The old manorial system of agriculture was rapidly vanishing and at the same time the artificers' gilds were declining in power.

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[1] Other "Utopias" were proposed in the Mercantilist period. Bacon's *New Atlantis* (1624), the Italian Campanella's *City of the Sun* (1637), and Harrington's *Oceana* (1656), aimed to describe ideal social arrangements. Ideas of a natural equality among men were expressed. Later the idea of a code of nature began to appear (e.g., Morelly, *Basiliade*). These "Utopias" are probably an indication of tendencies which finally found a very different expression in the French Revolution and *laisser-faire* economics.

The accompanying conditions were profoundly significant: "enclosures," the rise of a "free" labor class and the labor problem, competition. The seed of the problem of distribution was planted; and that force upon the working of which the young science of economics was to be based, was brought into play. Custom and status had ruled the Middle Ages. In the Mercantilist period we find statutes being enacted in the vain attempt to preserve the customary limitation of certain industries to certain towns, and widespread objection began to appear to the existence of many monopolies. For good or ill, *competition* began to take its place as a factor in controlling industry.

Extensive exchange and foreign commerce would hardly have been possible without money, and this the new silver mines in America made available in abundance (1540–1600). Toward the end of the period, banking reached such a stage of development in England that the Bank of England could be established. The influx of precious metals, together with debasement of coinage, caused a great rise in prices, and provoked much economic speculation. In the discussion introductory to this book, the financial difficulties of governments and the dissatisfaction of laboring classes with their condition appeared as two of the most fruitful causes of economic speculation. It is the first of these factors that chiefly stimulated Mercantilistic thought. Enormous extravagance often existed at court, but, aside from waste, the increased needs of government made the revenue to be obtained from royal estates and prerogatives less adequate. The result was a greatly increased use of taxation. The basis for taxation was, of course, being laid in the development of industry and commerce, which made available large sums of the increasingly necessary money. Greater security stimulated saving and banking.

Taxation being ostensibly for the maintenance of government, the political aspect of Mercantilism is suggested. It will become apparent that the object of Mercantilism was not so much to increase the wealth of the nation as to add to its power. In so far as wealth and power go together, the distinction has little significance; but the two are not always identical, and power was uppermost in the thought of the typical Mercantilist — the power of his nation. Thus the fishing industry was to be protected and high shipping rates to be borne, on the chief ground that shipping is that "in which consists the greatest honour and safety of the kingdom."

In the formation of nations and states two great relationships and two sets of problems arose, one external and one internal. Without, there was the struggle with other growing states; a struggle between the economies of the local units and the central government was taking place within. In government, typical Mercantilists stood for absolutism, for absolutism was an aid to that political unity which was in process of achievement. A degree of economic unity had to be achieved at the same time, as the existence of towns or provinces with monopolies and protected interests made political unity impossible. Despotism (a strong king) was the remedy for confusion and conflict (nobles, towns, and gilds). The celebrated "Wars of the Roses" (1455–1486) helped to lay the nobles low, and natural industrial evolution was a powerful ally in dealing with gilds and municipalities. In Hobbes' *Leviathan* (1651) one gets a good idea of the prevalent conception of the state: it was above the individual will; its right was to regulate the disposal of property; its duty was to encourage industry.

It is not to be overlooked, however, that with the beginning of a free labor class and the downfall of Feudalism a step was being taken which facilitated if it did not immediately lead to democracy. Industrial democracy, indeed, was far from existing. The most significant immediate result, from the standpoint of a history of economic thought, is, perhaps, the voice in public affairs that was given to the merchant — the representative of "big business" in those days. Harrison in his *Description of England* (Ed. 1577) wrote that "They often change estate with gentlemen, as gentlemen do with them, by a mutual conversion of one into the other." It is notable that instead of priests, philosophers, and jurists, with a few noble proprietors of large agricultural estates, it was the merchant prince who did a large part of the economic writing of the Mercantilist period.

Though no inconsiderable misunderstanding of Mercantilism has resulted from overlooking its domestic significance, still it is true that foreign relations furnished the focal point for the most typical Mercantilist doctrines. While it must not be forgotten that the interests of the nation and state constituted the ultimate end, it was in international relations that "those governments which understood how to put the might of their fleets and admiralties, the apparatus of customs laws and navigation laws, with rapidity, boldness, and clear purpose, at the service of the economic interests of the nation and state,"[1] gained their supremacy. From the economic point of view the essence of Mercantilism, which is state-making, can be appreciated best through the chief theories and policies which sprang from it and which make up *Mercantilism proper.*

The increased wants of the new states were occasioned chiefly by the growth of standing armies, coupled with rising prices. By the seventeenth century, warfare was vastly changed. Formerly there had been an hasty expedition, a pitched battle, and the issue was settled by courage; but at the time of which we write, as an eminent Mercantilist states, the whole art of war seemed, in a manner, reduced to money, and that prince who could best find money to feed, clothe, and pay his army, not he who had the most valiant troops, was surest of success and conquest.[1]

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[1] Schmoller, *The Mercantile System* (Ashley's Economic Classics series), p. 72.

Thus, "since war is grown so expensive, and trade is become so extended; and since luxury has so much obtained in the world, no nation can subsist of itself without helps and aid from other places; so that the wealth of a country now is the balance, which arises from the exchange with other places, of its natural or artificial product."[2]

To Sir Josiah Child, the most useful and necessary inquiry was, What is to be done to improve the nation's trade "to such a degree as to equalize or overbalance our neighbors in our national profit by our foreign trade?"[3]

These things are mentioned, not for the sake of bringing out the balance-of-trade idea, as such, but to show the importance attached to international relations. The hostility of the English toward the Dutch between 1660 and 1675 might also have been mentioned. Robert Clavell published a pamphlet (1665) which was one of several attacking the Hollanders and claiming England's ownership of adjacent seas. After the Dutch were crushed, hostile activity was centered on the French, imports being restricted in 1678, and a contemporary pamphlet proclaimed that "The French grow too fatt."[4]

The Policies and Theories of the Mercantilists.[5]—Though it is rather difficult to generalize concerning the theories and policies of Mercantilism, this much may safely be said: one great purpose dominated it, namely, the desire to make the state strong; the economic basis for strength, wealth, was given great weight; the most important form of wealth was considered to be the precious metals or "treasure"; foreign trade was generally preferred above other forms of industry, as best furnishing a supply of the desired kind of wealth; and, in measuring the success of this policy and of foreign trade, great importance was attached to the so-called "balance of trade." The dominance of a political teleology has been made sufficiently plain in what has gone before, and the emphasis of wealth will need no special comment. It remains, then, to discuss the last three generalizations.

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[1] Davenant, *An Essay upon Ways and Means* (1695), p. 16.

[2] *Ibid.*, p. 13.

[3] *Discourse of Trade*, p. 156.

[4] See Hertz, *English Public Opinion after the Reformation*, pp. 89, 97.

[5] Cf. the interesting account of "Nehemiah Grew: A Forgotten Mercantilist," by E. A. J. Johnson, *Amer. Econ. Rev.*, XXI, 463–480.

a. The Importance of "Treasure." It is no longer held that the Mercantilists believed the precious metals and wealth to be identical, or that they thought money the only form of wealth. There can be no doubt, however, that the typical Mercantilist sometimes confused the two things; and certainly he considered money the most desirable form of wealth,[1] drawing a distinction that we do not make between treasure and other scarce goods. One or two utterances from Mercantilist writers may serve to let the reader form his own opinion on this point. In his *Essays in Political Arithmetick* (1655) Sir William Petty makes the following statement: "The great and ultimate effect of trade is not wealth at large, but particularly abundance of silver, gold, and jewels, which are not perishable, nor so mutable as other commodities, but are wealth at all times, and all places; . . . so as the raising of such, and the following of such trade, which does store the country with gold, silver, jewels, etc., is profitable before others."[2] With a similar idea Mun wrote: "All nations who have no mines of their own, are enriched with gold and silver by one and the same means": by exporting goods to the value of twenty-two hundred thousand pounds and importing twenty hundred thousand pounds' worth, "we may rest assured that the kingdom shall be enriched yearly two hundred thousand pounds, which must be brought to us in so much treasure."[1] Child thought it a general and well-grounded opinion that gold and silver were to be taken "for the measure and standard of riches," and urged that by trade England was able to export goods which brought back "six times the treasure in specie."

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[1] E.g., "The general measures of the trade of Europe, at present are gold and silver, which, though they are sometimes commodities, yet are the ultimate objects of trade; and the more or less of those metals a nation retains it is denominated rich or poor." William Richardson, *Essay on the Causes of the Decline of the Foreign Trade*, 1744.

[2] P. 113

This emphasis of money as the most desirable form of wealth was a natural and not unreasonable result of conditions. Though Mercantilism is not to be attributed directly to the rise of a money economy, still, the growth of commerce, the changes in methods of warfare, and the introduction of the wages system gave money a new importance. The reader must remember, too, that it may be that some modern economists have tended to overlook the unique characteristics of metallic-standard money as a form of wealth, its relatively stable value and ready exchangeability, differentiating it to some extent from other valuable goods.

Again, there was not the opportunity for investment open to men that exists today. In the sixteenth century, industrial stocks and bonds were virtually unknown, and money took their place. So, too, with various credit agencies and instruments. Today they abound and make an important part of our medium for exchanges as well as form a means of investment. In a word, the relative importance of the precious metals was normally greater then than now.

It has been suggested that the character of the foreign trade of those days tended to increase the Mercantilists' emphasis of bullion. When spices, silks, wines, and the like played so important a part in exchanges, it was not so strange that writers

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[1] *England's Treasure by Forraign Trade* (London), 1669, p. 11. But it would be easy to misunderstand Mun by making "treasure" equivalent to our idea of the word "wealth."

"imagined that the chief use of foreign trade to England was to introduce gold and silver rather than nutmeg."[1]

b. *Foreign Trade.* — As to the means to be adopted for securing the desired treasure, that prince of Mercantilists, Thomas Mun, wrote: —

> "The ordinary means . . . to encrease our wealth and treasure is by Forraign Trade. . . . This ought to be encouraged, for upon it hangs the great revenue of the king, the honor of the kingdom, the noble profession of the merchant, the school of our arts, the supply of our poor, the improvement of our lands, the nursery of our mariners, the walls of the kingdom, the means of our treasure, the sinews of our wars, the terror of our enemies."

And Mun believed that only the treasure so gained — "by the ballance of our forraign Trade" — remained in the kingdom.[2]

William Petty in a similar strain gave it as his opinion that, "There is much more to be gained by Manufactures, than Husbandry, and by Merchandise than Manufactures."[3] And Sir Josiah Child held that those trades deserve most encouragement which employ most shipping; "for besides the gain accruing by the goods, the freight, which is in such trades often more than the value of the goods, is all profit to the nation."[4]

In a similar vein it was argued that the sailor was at once an artisan, a soldier, and a potential merchant; that fleets were valuable for defense; and that only through foreign commerce could countries having no mines obtain the coveted treasure in gold and silver.

Of course, since a nation could not export without producing, commerce necessitated manufactures. Articles of high specific value alone could bear the expense of transportation, therefore manufactures were favored next to trade and above agriculture.

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[1] Cannan, *Production and Distribution*, p. 3. The force of this observation, however, is weakened by the fact that foreign trade was praised and urged as a means for obtaining these things.

[2] *England's Treasure by Forraign Trade* (published 1669), p. 49; Economic Classics series, pp. 28–29. First edition 1664.

[3] *Essays in Political Arithmetick* (1691), p. 100.

[4] *Discourse of Trade*, Preface (1690). Child, however, favored exports of money in order to import and then reëxport goods, thus getting back six times the money exported.

That even this cardinal Mercantilist idea did not pass unchallenged, however, appears from the fact that in his *Discourses upon Trade*, Sir Dudley North argued that foreign trade could not subsist without home trade.[1]

¶c. *The Balance-of-Trade Idea.* — But howsoever great a nation's foreign trade might be, it was not sufficient unless there was a proportionate excess in value of exports over imports. This was the balance-of-trade notion.

Cossa says that we must distinguish three phases of Mercantilism: (1) Prohibition of the export of specie, including debasement of coinage and regulation of exchange; (2) "Balance of bargains," indicated by laws regulating contracts made by individual traders such as the "regulated companies"; (3) Balance of trade, involving the total trade of the nation. These distinctions, however, seem rather superficial, for the phases all center in the balance-of-trade idea, and prohibition of specie and regulation of contract were but means of gaining the great immediate end, — a favorable balance of trade. Moreover, these "phases" do not correspond to any clearly defined historical periods, either in industry or in thought about industry.

Child states the balance-of-trade doctrine as follows: —

> "It is the most general received opinion, and that not ill grounded, that this *balance* is to be taken by a strict scrutiny of what proportion the value of the commodities exported out of this kingdom bear to those imported; and if the exports exceed the imports, it is concluded the *nation* gets by the general course of its trade, it being supposed that the overplus is imported in *bullion*, and so adds to the treasure of the kingdom; *gold and silver being taken for the measure and standard of riches.*" [2]

Child himself considers the balance of trade to be simply the national gain or loss by foreign commerce, and thinks the best way of ascertaining it to be by observing the general state of trade and shipping. He also mentions the rate of exchange. Like Mun and Davenant, he enlarges on the difficulties of ascertaining the balance with any degree of accuracy.

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[1] North, *Discourses upon Trade* (1691), p. 16.

[2] *Discourse of Trade*, p. 153.

But without further illustration it may be observed that at least four somewhat different attitudes toward the balance of trade may be found among Mercantilist writers. (1) It was the original or vulgar idea that a favorable balance was a means or instrument by which the stock of precious metals in a given nation might be increased. This notion was apt to be associated with an overemphasis of treasure. Furthermore, it tended to confuse the means with the end: the balance of trade must ultimately depend upon industrial efficiency, and is thus the result rather than the means of securing treasure. (2) Or, a relative concept being added, it might be regarded as an agency for outstripping other nations, thus involving the fallacious notion that what one nation gained another necessarily lost. (3) Some looked upon the balance as being the general "net profit" of the nation on its annual trading, embracing specie, credit, and commodities.[1] (4) While still others saw in it simply an index to the state of the nation's trade, to be used like the rate of exchange, the amount of shipping, etc.[2] Of these views the third, with its specie or treasure element made by far the most prominent, was the most widely prevalent.

Such writers as Barbon (*Discourse of Trade*, 1690), who attacked the balance-of-trade idea, can hardly be classed as Mercantilists.

d. *Industrial and Commercial Regulations.* — The typical Mercantilist was greatly interested in increasing national productive efficiency. To put into execution the foregoing theories and policies, involved many contributory or supporting policies, and brought about a host of government regulations, duties, and bounties. An interesting attempt at classifying the various measures calculated to enable a nation to gain maximum efficiency in production, and to overbalance its neighbors in profits by foreign trade, was presented by one of the writers already mentioned. The classification embraces four general heads: [1] —

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[1] Davenant, who took this view, uses the phrase, "quick stock" (of the people of a nation), as equivalent to the balance of trade. *Essay on Ways and Means*, p. 13.

[2] These different uses of the phrase, "balance of trade," are not coördinate except in the broad way of having a bearing directly or indirectly upon the gain of the state by foreign trade. The fourth use of the phrase might be sub-divided, it being regarded (*a*) as an index to trade in general, (*b*) as an index to trade with some particular nation.

(a) *Increase the number of hands.* This might be accomplished through naturalization laws, religious toleration, freedom to hire as many servants, looms, etc., as desired, poor relief, and education.

(b) *Increase the amount of stock.* In addition to some of the above measures, laws for the transference of bills of debt, the enforcement of the navigation acts, various protective measures, and fewer holidays were advocated.

(c) *Make trade easy and necessary.* This desirable consummation was to be attained by the preceding agencies and by the establishment of a court merchant, abatement of interest, adequate convoys at sea, etc.

(d) *Make it the interest of other nations to trade with us.* By gaining their respect through a strong navy and army; by underselling, honest dealing, wise treaties, and restricting imports of manufactures, this end might be attained.

A scrutiny of the writings of the chief English Mercantilists shows that the government policies advocated, — and government policy makes the chief feature of Mercantilism, — may all be summed up as concerning population, its size and character; the development of natural resources; and various commercial devices.[2]

Under the first group of policies would come the advocacy of toleration and freedom of conscience, largely to attract industrious foreigners; careful provision for the poor and remedies for unemployment made a prominent point in various programs. Others stressed education, especially in arithmetic and accounts; while all agreed that "parsimonious" and thrifty living was imperative, as this would reduce the importation of foreign wares and, as in the case of clothes, leave a larger surplus for export. Mercantilists were all convinced that every man oweth to work, to use the language of an old statute, and compellable industry was a common idea.

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[1] Compare Mun, *England's Treasure*, Chap. III; and Child, *Discourse*, Chap. I. See also article on Nehemiah Grew, above referred to.

[2] These policies were largely drawn from Holland, for whose commercial methods and institutions the seventeenth-century Englishman had great respect. For Holland's thought see Laspeyres, *Geschichte der volkswirtsch. Anschauungen der Niederländer.*

As to natural resources, it was pointed out that by a better utilization of waste lands things then imported might be produced at home; and the development of the fisheries was an important policy. By "corn laws," which prohibited the importation of grain when the domestic price fell below a certain level, Mercantilists strove to stimulate and protect agriculture to the end that the nation might be self-sufficient and support an abundant population.

There is space to mention but a few of the many plans for facilitating and increasing commerce. For example, there was the public registry of mortgages and sales, the establishment of banks, the greater use of bills of exchange to allow more rapid settlements and turnovers, free importation of raw materials, exportation in British vessels, etc. Opinion was divided as to the efficacy of lowering the interest rate by law; but not a few deemed such a measure of the utmost importance.

✓Perhaps this is the place to refer to the colonial policy common to Mercantilists. Recent discovery and conquest had made colonies of great moment; and, in accordance with the foregoing ideas, the accepted treatment of them was to confine their industry as largely as possible to the production of raw materials, with the idea that the mother country should work these up and sell the finished product to the colonists. The net profit of the nation would thus be increased.✓

It is rather difficult to say how much of "social planning" there was in the minds of some Mercantilists, but it seems fair to say that there was no thought of "collectivism." The state or the ruler undertook much guidance in economic life; but (1) the state had little power or organization to control economic life or carry on industrial enterprise, (2) statistical information was inadequate, and (3) the predominant idea was to work through and for individuals, the great mass of regulations being obviously designed to promote, stimulate, and guide individual enterprise.[1] Thus, while there was little if any of *laisser faire*, there was also little of direct government enterprise, and no general acceptance of any doctrine of coercion for some ideal of the common welfare.

e. *Land-Bank Schemes and Money.* — The Mercantilist ideas concerning money easily led up to the various land-bank schemes which marked the close of the seventeenth century. Men who believed that an increase in the quantity of the circulating medium would correspondingly increase manufactures and trade, especially if, as was often the case, they also believed that "mony is a value made by a law" (Barbon), readily fell in with propositions to swell the monetary supply. Such men appear to have been Chamberlen, Briscoe, Barbon, and Asgill, in England, and Law, in France.

John Law (1671–1729), a Scotchman by birth, wrote a pamphlet, *Money and Trade Considered, with a Proposal for supplying the Nation with Money* (1705), which had a considerable influence. In it, he argued that "wealth depends upon commerce, and commerce depends upon circulation"; and he advocated a paper currency based upon land. Later Law was influenced by the growth of commerce and banking, and by practical experience, so that he came to advocate a purely fiat currency based upon the credit of the sovereign. In 1716, he succeeded in inducing Louis XV to establish a great central bank in France, but, after a pyrotechnical career, his schemes met financial ruin in 1720. He was, on the whole a Mercantilist, but he shifted from "treasure" to credit currency, passing through a land-bank phase in his thought.

This whole movement, however, is best considered as a by-product or side-issue of Mercantilism: it is not characteristic of the more typical period or representatives of Mercantilism, and

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[1] Mercantilist thought might be divided on this score. Some had the idea of national well-being as a total condition. Others were more interested in particular companies or trades.

Barbon and Law are to be classed as critics of Mercantilism. It will also be observed that its emphasis upon land is not so easily explainable in terms of Mercantilism as are its purely monetary aspects.

The Practical Application of Mercantilist Policies. — In accordance with such ideas, we find many acts for the encouragement of tillage, corn laws, navigation laws, and laws creating and regulating the staple, sumptuary laws, assizes of bread and ale. Probably it was in France under Colbert that the restrictive policy was carried farthest. We are told that "the state exercised over manufacturing industry the most unlimited and arbitrary jurisdiction. It disposed without scruple of the resources of manufacturers; it decided who should be allowed to work, what things they should be permitted to make, what materials should be employed, what processes followed. . . . Not the taste of the consumers, but the commands of the law must be attended to. . . . Machines were broken, products were burned, when not conformable to the rules. . . . An artisan could neither choose the place in which to establish himself nor work at all seasons, nor work for all customers. There exists a decree of March 30, 1700, which limits to eighteen towns the number of places where stockings might be woven. A decree of June 18, 1723, enjoins the manufacturers at Rouen to suspend their works from the 1st of July to the 15th of September, in order to facilitate the harvest. Louis XIV, when he intended to construct the colonnade of the Louvre, forbade all private persons to employ workmen without his permission, under penalty of 10,000 livres, and forbade workmen to work for private persons, on pain for the first offense of imprisonment and for the second of the galleys "[1]

In Prussia many measures were adopted to foster industry. These were partly negative, as the abolition of certain gild restrictions; and partly positive, as encouragements to immigrate and to marry, the establishment of mills and manufactories, the maintenance of lists of business opportunities, etc.

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[1] Dunoyer, *De la Liberté du Travail,* quoted by Mill, *Political Economy,* V, xi, 7.

There were also the usual limitations on exportation and importation. The policies seem to have been very wisely applied.[1]

Particular Economic Theories. — a. *Value.* — Clear evidence of the development which was going on during the sixteenth and seventeenth centuries in industry and philosophy appears in that part of economic thought which was devoted to value. Prior to this time, such thinkers as wrote on value generally conceived of it as inherent in things — as an intrinsic quality. Some saw more or less clearly its dependence upon human needs, but even these thought of it as belonging to the thing. Thus Aristotle had spoken of two uses of shoes, one for wear and the other for exchange. The medieval "just price" was an ethico-religious conception of a given value inhering in a thing and quite different from its price. This concept of value is really more nearly akin to that of "utility" as now held. It was dimly perceived that the power of a thing to gratify wants — aside from exchange considerations, and assuming the want — depended upon the quality of the thing or a quantum of cost contained in it.

The rise of exchange and money economy necessarily changed all this. It became impossible to consider value as an intrinsic quality of goods when value came to be measured in the changing prices of the market. The problem of the value of money came to be seen in a truer light, also, and money is not generally wanted for itself. More and more clearly the just-price concept became severed from actual market value, and more recognition and validity were given to the latter. The result was that by the end of the Mercantilist period value had come to mean generally an extrinsic market phenomenon dependent upon exchange.

Doubtless, too, the spread of a wages system threw a new light on the problem of economic value, and tended to emphasize cost.

Along with the industrial changes there came a development in religious and intellectual thought which tended to make the older idea of value unsatisfactory. Thus abstract moral and juristic dogmas lost influence and a long step was taken toward the development of economic science by the growing separation between ethical and economic considerations. Economic writing ceased to be confined to philosophers, priests, and jurists. A greater regard was shown for material things; for to an increasing extent men gave their minds to a concrete study of political or economic evils and the remedies for them. Significant of the time was the rise of a group of traders and statesmen whose empirical writings show this tendency.

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[1] See appendix to this chapter. Also Cole, *French Mercantilist Doctrines before Colbert.*

The fruits of a better appreciation of human personality and its worth appear in the works of a group of publicists and juristic philosophers who emphasized human reason, faculties, and desires, giving due weight in their "law of nature" to the nature of man. Accordingly, subjective factors gained in importance, and the conclusion came to be drawn that when the buyer and the seller were satisfied, the price was just.

Some of the foregoing developments were not completely carried out, and naturally did not affect all writers to an equal degree. The juristic philosophers showed more of the ethical motive in their thought; and the traders and statesmen generally were not concerned with the subjective aspects of value. It should be noted, too, that much of their writing was that of the pamphleteer and lacked the balance and breadth of the scientific treatise, just as the fugitive pamphlets of today are apt to do.

In the writings of the Mercantilists the transition noted in the preceding paragraphs can be pretty clearly traced. Passing over a group of Italian writers who sapped the medieval idea of just price,[1] the historian must mention the two juristic writers, Grotius [2] and Pufendorf.[3] The Dutch scholar, Hugo Grotius (1583–1645), drew upon Aristotle, Christian theology, and Roman law, but in his theory of value — which he discussed in connection with contract — he appears to have been chiefly influenced by the Greek philosopher. The German jurist and historian, Samuel Pufendorf (1632–1694), was largely indebted to Grotius and to the English philosopher, Hobbes. Both made needs and desires — in the inclusion of the latter going beyond Aristotle — an important element in value; and they implied a distinction between value in exchange and utility. Hobbes, in discussing value in his *Leviathan* (1651), emphasized individual estimation. He referred to the "value or worth" of a man as being his "price" — that is, what would be given for his services — and as being dependent upon the "need and judgment" of others. The buyer, he argued, rather than the seller determines prices: "The value of all things contracted for is measurable by the appetite of the contractors, and therefore the just value is that which they be contented to give."[1] Following Hobbes, Pufendorf stressed "moral estimation," and said "The foundation of the price or value of any action or thing is, fitness to procure, either mediately or immediately, the necessaries or conveniences, or pleasures of human life." The degree of scarcity, however, was allowed some weight.

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[1] E.g., Buoninsegni (1591); Scaccia (1618).

[2] *De Jure Belli et Pacis* (1623), Bk. II, Chap. XII. See Laspeyres, E., *Gesch. d. volksw. Anschauungen der Niederländer*, p. 3.

[3] *De Jure Naturae et Gentium* (1672), Bk. V, Chap. I.

Both the continental writers attached a considerable degree of validity to the prices determined by competition, and Hobbes' statement concerning "just value," quoted in the preceding paragraph, is notable.

In the thought of at least two of these men, however, appears the notion of a sort of basal value, akin to the "normal value" of present-day economists, resting on cost of production. For illustration, Grotius said that "account is commonly taken of the labor and expense of the sellers"; and Pufendorf held that in regulating "natural price," regard is to be had to the "labor and expense of the merchant" and his risk, which idea seems to lead back to a "just-price" doctrine.

Within the group of traders and statesmen, less attention was paid to subjective ideas of value, and value was thought of as determined by objective forces outside of the individual estimation. Two representatives of this group will suffice, namely, Petty and Locke. Sir William Petty makes value rest on expenses of production, reducing them to labor and land. "Labour is the father and active principle of Wealth, as Lands are the mother." But he seeks to reduce these two expenses to a single unit, "so as to express the value of anything by either alone." [1] Market or "extrinsic" values rise or fall according to supply and demand. According to Locke, labor is the almost exclusive source of value, for he says, "it is labour indeed that puts the difference of value on everything." [2] "Nay, if we will rightly estimate things as they come to our use, and cast up the several expenses about them, what in them is purely owing to nature, and what to labour, we shall find, that in most of them ninety-nine parts out of a hundred are wholly to be put on the account of labour."

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[1] Hobbes' *English Works*, Vol. III, Chaps. X and XV.

These two writers, then, are to be taken as forerunners of the later labor theories of value. They represent the majority of English Mercantilists proper.

To sum up, it may be said that in the writings of the Mercantilists can be found suggestions of most value theories since developed, and the ideas of Adam Smith and the English Classical School may be traced directly to them. (Hutcheson used Pufendorf as a text, and Smith was a student of Hutcheson's.) These suggestions were not fully worked out, however, and it is difficult to classify them clearly. The distinction was drawn between "intrinsic" and "extrinsic" values; the former depending on needs and desires and the inherent fitness of things to gratify them, the latter upon supply and demand or cost. The earlier writers appear to have given most attention to intrinsic value, meaning what is now generally called utility. This was sometimes called "natural value," and by Pufendorf *pretium vulgare* (value in use). As exchange and money became more important, extrinsic value came in for more attention. It was called artificial or accidental or market value. Pufendorf contrasted *pretium eminens* (purchasing-power value) with value in use, and it is significant that he seems to have thought of it in connection with money only. This was exchange value. Cutting across the extrinsic or exchange value class, was the distinction found in a few cases (e.g., Locke, Fortrey) between natural (normal) value based on cost, and market value determined by "vent" (demand) and scarcity (supply).

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[1] Petty's Economic Writings (Cambridge, 1899), Vol. I, p. 181. See Rost, *Wert.- u. Preis-Theorie*, pp. 29 ff.; Sewall, *Theory of Value before Adam Smith*, pp. 70 ff.

[2] *Essay on Civil Government* (1690), London, 1772, p. 210.

The idea of "natural" value, in which the play of competitive forces was recognized, was substituted for just price, — an important step in the development of the science.

It remains to touch upon a few notable exceptions. The Italians, Davanzati [1] and Montanari,[2] and the Englishman, Nicholas Barbon,[3] will suffice. These men laid the greater emphasis upon utility, and held subjective theories of value. Thus Barbon wrote: "The value of all wares arises from their use; things of no use, have no value, as the *English* phrase is, *they are good for nothing*." And again, "for the value of things depending on the use of them, the *over-pluss* . . . become worth nothing; so that plenty, in respect of the occasion, makes things cheap; and scarcity, dear." These men, together with some of the others already mentioned, helped to keep alive a recognition of the subjective element in value.

b. *Interest.* — No unanimity exists among Mercantilist writers on the subject of usury or interest. Thomas Mun, about the middle of the seventeenth century, argued in favor of interest-taking on the ground that money-lending enabled poor young merchants to rise and made possible the advantageous employment in trade of the funds of widows, orphans, and gentlemen. As to the nature of interest, his conclusion was "contrary to those who affirm that trade decreaseth as money increaseth, for they rise and fall together,"[1] — that is he considered the interest rate as ~~a result rather than a cause~~ of industrial conditions.

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[1] *Lezione della moneta*, 1588.
[2] *Della moneta*, 1680 circa.
[3] *A Discourse of Trade*, 1690, Chap. III.

About 1668, a controversy over usury laws sprang up. In conflict with Mun's views, Sir Thomas Culpeper had written two tracts in favor of establishing lower interest rates;[2] and his son published a "Discourse" attacking usury. But perhaps the most eminent sponsor for this notion was Sir Josiah Child. He maintained that a low interest rate was the natural mother of frugality and industry, that it would attract traders by making capital cheap, and compel frugality by making smaller "profits" necessary! A high rate of interest made money scarce because every man as soon as he has saved a little, sent it to the goldsmith. The whole burden of such arguments was, "We shall never stand on even ground with the Dutch in trade till interest be the same with us as with them."[3] Likewise, Davenant took a fling at those who received interest: "The usurers, who are the true drones of a commonwealth, living upon the honey without the labor," should be taxed.[4]

Most of these men thought that a law reducing the interest rate would be effective and make money cheap. Evidently they got the cart before the horse and made the effect the cause, all of which indicates a lack of understanding of the functions of capital and money.[5]

On the other hand, there were some who took Mun's side in the usury controversy. One, Thomas Manley, explained that "as it is the scarcity of money (and many borrowers) that maketh the high rates of interest, . . . so the plenty of money and few borrowers will make the rates low." John Locke, too, while not understanding the causes of the value of money, argued that low interest rates were the result of a plentiful supply of money. And Sir Dudley North, who did not accept some of the Mercantilist doctrine, upheld this end of the controversy, explaining that an abundant "stock" and security made rates low in Holland.

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[1] *England's Treasure by Forraign Trade*, p. 127; Economic Classics series, pp. 77–81.

[2] *A Tract against the High Rate of Usurie*, 1621; *ibid.*, 1640. In the first he favored reduction from 10 to 8 per cent; in the latter — this reduction having been made — he desired a 6 per cent legal rate.

[3] *Discourse of Trade*, pp. 27, 29, 167, and Preface; for the situation in Holland see Laspeyres, *Anschauungen der Niederländer*, p. 256.

[4] *Essay on Ways and Means.*

[5] Cossa, in his *Introduction to the Study of Political Economy*, certainly speaks too strongly in calling Child remarkable for his sound understanding of money without noting this limitation. By Child's time money was largely invested in profitable ways.

Of the preceding writers, excepting North, it may be said that if they had any conception of the relation between the productivity of capital and interest it was but a faint one. Their notion of "profits" was naïve and unanalyzed; "usury" was any payment for the use of money.

Nicholas Barbon, however, while arguing for a decreased rate of interest, saw this relation; for he wrote: "Interest is commonly reckoned for mony; . . . but this is a mistake; for the interest is paid for stock. . . . No man takes up mony at interest, to lay it by him, and lose the interest of it." [1] And North in his *Discourses upon Trade* (1691) is perhaps another exception.[2]

c. *Population, Wages, Rent.* — It would be wrong to make the desire for a dense population, as such, one of the cardinal features of Mercantilism; but, partly for purpose of war and partly for increase in production, Mercantilists desired a numerous people. By employing many people the king's revenue would be increased. Cheap and abundant labor was necessary to enable home products to compete successfully with those of foreign countries; hence the laws and regulations encouraging matrimony and parenthood. Samuel Fortrey announces that "People and plenty are commonly the begetters the one of the other, if rightly ordered"; [3] Davenant says, "People are the real strength of a country";[1] and Child, that "it is in multitudes of People, and good Laws, such as cause an Encrease of People, which principally Enrich any Country."[2] Fortrey was notably explicit in his writing on this subject. Two things, said he, make a nation great and powerful: riches and population. To increase the latter he favored freedom of immigration and the granting of equal rights to immigrants, — this on the ground that they would bring riches with them and improve trade and industry. In answering objections — for there were opponents — he maintained that improved industry would benefit all citizens, and he even went so far as to argue that it would be an advantage to make land dearer, asserting that "it might be wished, nothing were cheap among us but only money!"

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[1] *Discourse of Trade*, pp. 31, 32.

[2] "But as the Landed Man letts his land, so these still lett their stock; this latter is call'd Interest, but is only Rent for Stock, as the other is for land." " . . . if there be more Lenders than Borrowers, Interest will also fall; wherefore it is not low Interest makes Trade, but Trade increasing, the Stock of the Nation makes Interest low." (p. 4.)

[3] *England's Interest and Improvement* (1663), p. 4.

It was the idea of the philosopher, Hobbes, that when the multitude of poor, strong people increased, the overplus should go to the colonies; and he made this striking statement: "when all the world is overcharged with inhabitants, then the last remedy of all is war; which provideth for every man, by victory or death."

The Mercantilists appear to have had no theory of wages or rent. As already suggested, they were more or less unsystematic pamphleteers; and their ends concerned production rather than distribution. It is true that Petty saw that the value of labor is derived from its product, that Child stated that wage regulation is unwise, etc.; and the latter writer observed that rent had fallen in England as the result of improvement in Ireland and high land taxes.[3] But these ideas were not developed.

d. ***Factors of Production.*** — Of more significance are their utterances concerning the factors of production: these have interest in connection with their probable influence upon both the Physiocrats and Adam Smith. For example, Petty's famous dictum "Labour is the father and active principle of Wealth, as Lands are the mother," is most significant in both relations. Child refers to "the inseparable affinity that is in all nations and at all times between land and trade, which are twins, and ever will wax and wane together." Davenant keeps the foreign trade idea to the front, remarking that "the price of land, value of rents . . . rise and fall, as it goes well or ill with" commerce; but delivers himself of the following generalization: "The wealth of all nations arises from the labour and industry of the people,"[1] a statement which reminds one of Adam Smith.

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[1] *Essay on Ways and Means.* A dense population makes invention, frugality, and industry necessary, which bring a nation riches.

[2] *Discourse of Trade,* Preface. (See also Petty, *Political Arithmetick,* pp. 107, 123; Barbon, *Discourse of Trade,* p. 39.)

[3] *Discourse of Trade,* Preface. (See also Petty, *Political Arithmetick,* pp. 107. 123; Barbon, *Discourse of Trade,* p. 11.)

Barbon, who was hardly a Mercantilist, said that "land is the fund that must support and preserve the government," and was himself interested in a land bank.

e. *Productivity of Different Occupations.* — In general, as already remarked, Mercantilists believed that the merchant was "the best and most profitable member of the commonwealth," and that after him came the artisan. One of their number makes a summary statement which covers the whole matter of productive and unproductive labor. He writes: "It is (I think) agreed on by all that Merchants, Artificers, Farmers of Land[2] and such as depend on them . . . are the three sorts of people which by their study and labour do principally, if not only, bring in wealth to a nation from abroad; other kinds of people, viz. Nobility, Gentry, Lawyers, Physicians, scholars of all sorts, and shopkeepers, do only hand it from one to another at home."[3]

These ideas are of significance in the history of economic thought in two ways: they indicate a great change from the times, medieval and ancient, in which agriculture was placed first; and they are to be associated with the notions of Adam Smith and the Physiocrats concerning the non-productivity of certain classes. It is of no little interest, and importance, too, to observe how economists have denied productivity now to this class, now to the other.

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[1] "Of the Use of Political Arithmetic," *Works*, Vol. I, p. 139. (London, 1771.)
[2] Note the order.
[3] Child, *Discourse of Trade*, p. 25.

The belief that certain occupations are not so productive as others, all things considered, has been a long-continued one. The intermingling of ethical ideas makes it difficult to compare these beliefs; but it may be said that they are determined largely by the dominant class. Thus, in the Middle Ages, agricultural interests dominated; by the seventeenth century, commerce was in the ascendancy; in the middle of the eighteenth century, as will appear later, there was a renewal of interest in agriculture; while the Industrial Revolution put manufacturing interests to the front. Accordingly, the Mercantilists thought that as gentry, professional men, and retailers had little connection with bringing in treasure, they were in that sense non-productive; while in 1776 Adam Smith considered that similar classes were not productive in the sense that they did not put vendible goods on the market.

f. *Taxation.* — Worthy of notice, also, is the thought of the Mercantilists on taxation. In general their idea was that men should be taxed according to the benefits received from the state.[1] This idea was in accord with the prevalent notion of a "social contract." According to Hobbes, the test for benefit should be expenditure. The man who saves should not be penalized; "when the impositions are laid upon those things which men consume, every man payeth equally for what he useth, nor is the commonwealth defrauded by the luxurious waste of private men."[2] Grotius and Pufendorf held that burdens must correspond to benefits received in the shape of protection.

Sir William Petty has been called the first English scientific writer on taxation. His words are: "It is generally allowed by all that men should contribute to the Publick charge, but according to the share and interest they have in the Public Place; that is according to their Estate and Riches."[1] He favored the expense index, that is, taxation in proportion to expenditure.

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[1] See Seligman, *Progressive Taxation in Theory and Practice*, pp. 158, 162. (Publications of the American Economic Association, 1908.)

[2] *Leviathan*, p. 271. (Reprint of 1881.)

Other Mercantilist empiricists dealt with this important subject at some length, and formulated several practical doctrines. In general, low customs and an increased use of excise taxes were favored. Equality in taxation was urged, and to this end a tax on money at interest, — while the impracticability of taxes on easily concealed wealth was seen.[2]

James Steuart: "the Last of the Mercantilists." — Sir James Steuart[3] (1712–1780) was the chief English Mercantilist writer of the eighteenth century. Indeed he has been called the last of the Mercantilists. Following the Stuarts into exile in 1745, he lived in France, Germany, Holland, and Italy; and his book (1767) is largely a collection of observations made during this time. Its title is *An Inquiry into the Principles of Political Economy, being an Essay on the Science of Domestic Policy in Free Nations, in which are particularly considered Population, Agriculture, Trade, Industry, Money, Coin, Interest, Circulation, Banks, Exchange, Public Credit and Taxes.* This seems to be the first use of the term Political Economy in an English book. His idea of the science has Mercantilistic earmarks: "Œconomy in general is the art of providing for all the wants of a family, with prudency and frugality. What œconomy is in a family, political œconomy is in a state. . . . The principal object of this science is to secure a certain fund of subsistence for all the inhabitants" and to render it secure. Economics is an art. Mercantilist ideas concerning population also appear.

Money and banking are treated at considerable length. Steuart justifies interest, but has no clear understanding of capital — as was commonly the case before the Industrial Revolution. Also, like Child, he feels that a low rate of interest would be beneficial, only governmental measures to secure it should be gradual.

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[1] *A Treatise of Taxes and Contributions* (1677), p. 68.

[2] See Davenant's *Essay on Ways and Means.*

[3] *Feilbogen,* "James Steuart u. A. Smith," in *Zeitschr. f. d. ges. Staatswissenschaft* (1889); Hasbach, *Untersuchungen über A. Smith,* pp. 81 ff. (1891).

He has some sound ideas on price, regarding it as determined by demand and supply, and distinguishing "effectual" demand; and Adam Smith has been criticized not unjustly for not referring to Steuart on this point, as Steuart's work was well known to him.

It is interesting to observe the influence of French thought upon Steuart. In France the Physiocratic doctrines, to be described shortly, were taking shape. Accordingly we find stress laid upon the agricultural surplus as conditioning the growth of population and industry, and his model state was pervaded with a characteristic unity and harmony.

The book is diffuse and woefully lacking in clear definition and accurate statement. This fact, together with the changes wrought by the Industrial Revolution and the appearance of Smith's *Wealth of Nations*, deprived Steuart's work of any considerable recognition or effect, though it appears to have had some influence in Germany.

The Philosophy of the Mercantilists. — Several of the leading Mercantilist writers were philosophers, and, of course, all proceeded upon certain fundamental assumptions concerning man's place in the world and the meaning of industrial and social life, though they may not have been conscious of this fact. Some went far toward assuming that management and human arrangements could control economic life, but they were concerned with material matters and they had few illusions as to the perfectibility of man, the organic nature of society, or the power of the human spirit to transcend the limitations of environment. Theirs was the philosophy of materialism as defined in the introductory chapter of this History. Hobbes, in his *Leviathan*, wrote that "nature hath made men so equal, in the faculties of the body, and mind" that no great difference exists among them, and no one can claim any benefit therefrom to which another may not pretend. Locke, though somewhat inconsistent, on the whole may be said to have made environmental influences primary and to have regarded the mind as passive.

Self-interest was the force more or less consciously assumed by all to motivate men, and the principle of least sacrifice was supposed to guide them. Thus Hobbes stated that "every man is presumed to do all things in order to his own benefit," and Fortrey that "Interest more than reason commonly sways most men's affections . . . and the hope of gain commonly bears so great a sway amongst men, that it alone is sufficient to prevail with most."

The Mercantilists, furthermore, regarded self-interest as leading to clashes of interest between individual selves and the state. One finds hardly a trace of the doctrine of a natural "harmony," which was to play so large a part in later economic thought. Hobbes thought that men differ from ants in that among these creatures the common and the private good are the same, while among men there is continual competition for honor and dignity.[1] Fortrey wrote bluntly: "But private advantages are often impediments of publick profit . . .";[2] and Child urged his readers to "warily distinguish between the profit of the merchant and the gain of the kingdom, which are so far from being always parallels, that frequently they run counter one to the other."[3] Clearly, these men held to no preconceived notion of a natural harmony of interests, but rather anticipated conflict. In fact, their ideas here and concerning population, contain some seeds of pessimism.

Critical Estimate and Summary. — It must not be thought for a moment that the preceding statements will apply to all writers who may properly be called Mercantilists, nor that they will apply in their entirety to any one of them. In some cases they are generalizations or analyses, which the men of the seventeenth century do not appear to have made expressly. In other cases there were exceptions, some of which have been pointed out. But it is believed that a congress of Mercantilists would have agreed by a large majority vote to any of the above propositions which have been made in a general way.

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[1] *Leviathan* (English Works), Vol. III, p. 156.

[2] *English Interest and Improvement*, p. 3.

[3] *Discourse of Trade*, Preface.

The conclusions to be drawn from the foregoing discussion seem to be that the Mercantilists were inclined to lay too much weight on the advantage of gold and silver as compared with that of other commodities; that they overestimated the value of commerce, or, perhaps it would be better to say, underestimated the relative importance of agriculture and other branches of human industry; and that they erred in supposing that a favorable balance of trade necessitated a benefit in the long run. They were in error, too, in being too much inclined to regard what one nation gained as necessarily the loss of another. A harmony of interests, it is true, does not always obtain as between different countries. A good part of what England gained by the Navigation Act, Holland lost; American competition at the beginning of the twentieth century was injuring very sensibly the interests of important classes in England and on the Continent. Nevertheless a more scientific examination into the theory and practice of international trade was ere long to show that in free exchange both parties generally gain.

Industrial developments led the Mercantilists to abandon the doctrine of just price, though traces of the idea may be found; and they were forced to give more consideration than their predecessors to "extrinsic" or market values, and to the subjective elements therein. They maintained the concept of "intrinsic" value, however, and consequently did not make the clear distinction between value and utility that was necessary before much progress could be made. A cost theory of value, with the labor element emphasized, was held or implied by some of the most prominent writers.

On the whole, interest was defended and a few had some inkling of the reasons for it. Many, however, thought it was something to be determined by the state, and thus showed imperfect ideas about capital.

Criticism of the Mercantilists' ideas has been carried too far in not a few cases. They contained errors unquestionably, and the germs of an unhealthy development; but they are far from a mass of absurdities when considered, as they must be, with regard to time, place, and, above all, to the spirit of the people. It is nonsense to believe that exports can exceed imports in all countries. But the Mercantilists never claimed this belief. They did not generalize. They were laying down the principles of a national political economy, not a cosmopolitan one. War was the normal thing, and a large degree of self-sufficiency a practical necessity.

Some explanation of their ideas concerning treasure has already been given. Now let it be forgotten for the moment that gold and silver are money, and let them be considered merely as other commodities. Then let the question be put: how is a people which has not the commodity, gold, or the commodity, silver, but has other commodities, to obtain the former peacefully? The reply is simple: by exchanging commodities. One can conceive of no other way. Now that is one thing which the Mercantilists of England, France, and Germany wished to do. They wished to trade off some of their wares for gold and silver, and they actually accomplished their purpose. Spain lost gold and silver, and they obtained it. As a temporary expedient under existing conditions, the balance-of-trade theory was justifiable. The Mercantilists erred chiefly in so far as they regarded it as a proper permanent national policy. But is the error not natural? Most men hold the same notion to this day, and that without the reasons which existed over two hundred years ago!

To apply a practical test, it may be said that Mercantilism was for a time fairly successful. The French free trader, Blanqui, acknowledged freely the benefits France derived at one time from a governmental supervision of trade and commerce. Even Adam Smith admits that Cromwell's famous Navigation Acts, which prohibited foreigners from bringing into England any goods that were not the product of their own country, were of advantage to England, and approves of them. As to German

Mercantilism, Mirabeau wrote of Silesia, a region which received particular attention from Frederick the Great, "There reigns there a population, a culture, and an industry truly immense." And other contemporaries confirm this, explaining the want of prosperity in other German states by a lack of proper initiative on the part of their governments. Under the conditions of the time there was a lack of energy and go-ahead on the part of private individuals, so that when the government did not lead, stagnation in industry was the rule.

Coupled with this idea is the fact that Mercantilistic philosophy was based upon a belief that private and social interests are not necessarily in harmony. The reader of the Mercantilist pamphlet was to distinguish warily between the profit of the merchant and the gain of the kingdom, for "frequently they run counter one to the other."[1] This concept by no means had the content of the similarly worded one common today, nor did it lead to all the conclusions now drawn; rather, Mercantilism often meant absolutism and the means by which the ruler and certain privileged classes could use the state for their own aggrandizement. Then, as now, however, regulation of industry by the state was the logical outcome.

The essence of Mercantilism proper was the application of the independent-domestic-economy idea of self-sufficiency to nations, — an old system of thought to a new group of phenomena. One sees it in the attitude of the state toward trade and industry; it appears in the balance-of-trade idea; it lies back of the overestimation of precious metals. This was more or less conscious with the Mercantilists. Mun wrote concerning the balance of trade: ". . . it cometh to pass in the stock of a kingdom, as in the estate of a private man." Child puts it as follows: there is "a great similitude between the affairs of a private person, and of a nation, the former being but a little family, and the latter a great family."[2]

It is, then, simply the idea that has always dominated the trader and which is prevalent among merchants to this day:

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[1] Child, *Discourse of Trade*, Preface.

[2] *Ibid.*, p. 164.

patronize home industry; so conduct your business that the profit and loss account of the year's trading shows a balance in your favor; etc. "Whatever nation," says Davenant, "is at a greater expense than this balance admits of, will as surely be ruined in time, as a private person must be, who every year spends more than the income of his estate."

Thus we arrive at a body of policies, designed, by government regulation of commerce and industry, to secure a large net profit for the state as a trader, — or better, perhaps, the traders in a state — in the shape of treasure. This is Mercantilism proper.

Mercantilism after the World War. — In several important respects, a recrudescence of Mercantilism developed following the depression of the nineties, and came to a head with the World War, and particularly after 1921. This is illustrated by the emphasis on the gold hoards of various nations, and related policies as to tariffs, import quotas, and exchange restrictions. Internally, too, there was a predominance of "policies," based upon political considerations, and centering in the financial difficulties of the state, which resembled Mercantilism, — with bounties, detailed regulations, price fixing, debasement of currencies, etc. In general, the spirit of nationalism was strong, and the cosmopolitan trend of economic thought was checked.

Nor is it difficult to trace all this to conditions similar to those of the Mercantilist period, such as great wars, rapid industrial and financial changes, currency and price instability, international competition for gold, and a tendency to concentrate power in the state.

Indeed, the tendency arose to deny the validity of economic laws, to treat economics as an art, and to place a naïve confidence in opportunistic legislative expedients, much as in the seventeenth century.

This Neo-Mercantilism of the post-war period naturally differed in several respects from the older Mercantilism, and especially in that it appealed to a more idealistic philosophy. It depended more upon effective "social planning" of economic life, either through complete centralization under a dictatorship or through mass action under a "democratic" form of "regimentation." And it was backed by much greater and more precise statistical information.

It is of interest to note that this period may illustrate one of those cases in which an evolutionary process goes on in some parts of the world and not in others, producing "lags" which eventually cause social "strains" — in this case world wide. Some nations did not really participate in the Mercantilism of the eighteenth century, and several did not achieve the developments attained in England and France. In short, they did not attain either national unity within, or an established place in the family of nations outside. Among these, we may list Italy, Russia, and, to a considerable extent, Germany. Thus it is that Fascism in Italy became a sort of Neo-Mercantilism, in addition to its other aspects.

In the United States, moreover, there was a lack of internal unity, economically speaking, which arose from wide sectional differences of interest, and was intensified by "States' rights."

The struggle in the less unified and integrated nations to achieve a fully developed nationalism, no doubt had something to do with the War; but more especially it had much to do with the economic warfare which followed the military struggle. And this reacted on the others. So there became fully developed in the 1930's a sort of reversion to Mercantilistic policies, having as a prominent feature the establishment of unity within certain nations, through dictatorships and "social planning," and a correlated effort to protect the national economic life against others by trade and monetary regulations.

Note: General references on Mercantilism: — Beer, M., *Early British Economics*, 1938; Heckscher, E. F., *Mercantilism*, 2 vols., 1935; Johnson, E. A. J., *Predecessors of Adam Smith*, 1939; Viner, J., *Studies in the Theory of International Trade*, 1937, Chaps. I–II.

APPENDIX TO CHAPTER VII

GERMAN MERCANTILIST POLICIES

Through Professor Gustav Schmoller's admirable little work on German Trades in the Nineteenth Century [1] we can trace in detail the operations of Mercantilism in Germany. From 1650 to 1800 Prussian industry was directly under the guidance of the state authorities. It is true that in some respects the monarchs of Prussia exercised their power to increase industrial liberty; but only in so far as it seemed good to them, and they never let the reins slip out of their hands.

The Great Elector, Frederick William, issued edicts in 1667, 1669, and 1683 to encourage the cultivation of places that had been laid waste by the Thirty Years' War. One measure attempted to draw people to the cities by removing the tax (*den Schoss-scot*) resting on houses and substituting an excise (*Accise*) in the cities, with the expectation that this would cheapen houses and reduce the cost of living. This was not a financial but a political measure, it must be noted, and was an act of state interference. It had the desired effect. A large demand for houses manifested itself in the Prussian cities, and many merchants and tradesmen immigrated. Edicts were issued in 1686 and 1688 to improve the whole organization of the trades. Many restrictions which the gilds had kept in force, limiting the number of masters, journeymen, and apprentices, were removed. All immigrants received free of charge the rights of a master tradesman and those of a citizen. The linen industry in Ravensberg in Westphalia was assisted by an institution of state for measuring the length and breadth and determining the quality of linen and stamping it accordingly. The effect of this was to give purchasers confidence in the products of the manufacturers.

Frederick I, who reigned as king from 1701 to 1713, continued the policy of the Great Elector. Immigration was artificially encouraged. Magdeburg was rebuilt by settlers out of the Palatinate. Up to 1690, forty-three new kinds of trades had been established in the Mark, the province in which Berlin is situated, by the French and the Walloons.

Frederick William I ("der sparsame kluge hausväterliche Tyrann"), who reigned from 1713 to 1740, went still farther in the direction in which his predecessors had gone. He forbade the exportation of raw material, especially of wool. The importation of foreign manufactured articles was either entirely forbidden or rendered difficult by the imposition of heavy duties. The government established fullers' mills, dyeing establishments, presses, and wool magazines. To encourage certain classes of foreign artisans to marry, privileges were granted them for *three years* after marriage — among others, full exemption from taxes or exceptionally low taxes and freedom from military service. Several times, as in 1718 and 1721, lists of tradesmen and artisans who had failed in different cities or had quit business were published, so that the vacancies might attract attention and call in others to take their places.

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[1] *Die deutschen Kleingewerbe im 19ten Jahrhundert* (Halle, 1870).

Frederick the Great (1740–1786) continued his father's policy. He granted religious and intellectual toleration, and administered justice with impartiality, not merely for the sake of these good things themselves, but also to increase population by making Prussia the goal of emigrants fleeing from persecution. His efforts brought at least 30,000 immigrants into Silesia alone.

Important industrial activity was the result of this application of the principles of the Mercantilists. Schmoller enumerates the following industries which owe their origin to the policy of Frederick the Great: the mines in Silesia; an iron manufactory in Eberswalde (Neustadt-Eberswalde until 1876); the Berlin iron foundry, in which the entire Berlin industry in manufacturing machines had its origin; the manufactory of silk in Crefold; the weaving industry in Elberfeld and Barmen; and the linen industry in Billefeld. Dutch bleaching establishments were founded.

A court was established which exercised jurisdiction over matters of commerce and bleaching; and to crown the whole, state diplomacy was used to assist the manufacturers in selling their products. Spinning and weaving were controlled by minute regulations. It was forbidden to export yarn. Spinning was encouraged in every way; the soldiers were ordered to spin; the spinners of cotton were paid annual premiums, and received privileges such as exemption from taxation. Edicts were issued and regulations framed for the purpose of assisting artificially the small tradesmen to obtain credit and the means of procuring raw material.

CHAPTER VIII

EARLIER GERMAN MERCANTILISTS AND KAMERALISTS [1]

> Teutschland hat zu seinem schaden,
>   O der grossen raserey!
> Fremde kauf-leut eingeladen,
>   Das es ja bald geldarm sey.
> Fremde waaren, welche leyder!
> Bringen nichts als fremde kleider,
>   Machen unser teutsche welt
>   Reich an hoffart, arm an geld.
>
> VON HORNIG.

1. Résumé of the Nature, Scope, and Development of Kameralism. — For some three hundred years or more the economic thought of the German states and Austria was largely embedded in that body of learning known as Kameralism or *Kameralwissenschaft.* This was the German Mercantilism, a Mercantilism which deserves separate study because of its peculiar problems, its relatively full and consistent formulation, and its close relation to more recent German Economics.

In the Middle Ages the word *Camera* (German *Kammer*) designated the place in which the royal income was stored. By the Frankish kings the royal treasure chamber was called Kammer, and the term soon came to apply to the royal property. Thus Kameral affairs concerned the economy of the prince, and Kameralism was the art which maintained, increased, and administered the royal income. After the erection of the Hofkammer by the Emperor Maximilian, — at Innsbruck and at Vienna

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[1] For a more complete statement of Kameralism, see Small, *The Cameralists;* Chicago, 1909. The present chapter was prepared some months before the appearance of Professor Small's book, and, its conclusions having thus been independent, the substantial unanimity of the two is of interest. The writer has had access to a copy of Hornig's *Oesterreich über alles,* which important work Dr. Small unfortunately could not obtain. The writer would, perhaps, lay more emphasis on the economic element in Kameralism than does Professor Small, — while he realizes the large proportion of politics and technology embraced.

(1493 and 1501), — a knowledge of the principles and duties involved in its administration became necessary, and chairs for instruction in such knowledge were later founded in various universities.

At the outset, Kameralism was a combination of ideas, political, juristic, technical, and economic; but toward the close of the Middle Ages it became largely separated from jurisprudence, while it was extended to include, besides the original idea of domainal and regalian administration,[1] broader matters of economic policy. Then, during the eighteenth century, technical subjects were more and more dealt with, until in the early nineteenth century there was a reaction, and economics was severed from technology. This was, no doubt, partly effected by the evolution of political economy in France and England. Schmalz, writing in 1819 (*Encyclopedia of Kameralistic Sciences*), made Kameralism include all matters pertaining to the property and income of the people, their acquirement and increase, and taxation. Two distinct branches were technology and political economy. And Rau (*Ueber die Kameralwissenschaft*, 1825) distinguished private and technical economy from the public and political.

Throughout its entire development Finance figured prominently in Kameralistic thought.

To understand this thought one must remember that the great stimulus to the thinking of the early Kameralists lay in the relatively backward industrial condition of the German states. From the reign of Charles V to the close of the Thirty Years' War, Germany was split up into a political chaos of struggling princely and burgher economies. In vain (1522–1523) was the project of a national tariff wall raised; and Copernicus proposed a uniform currency to no avail. The political struggle concerning coinage ("Der Münzpolitische Streit") of 1530 was typical.

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[1] Domains included royal estates, crown lands, etc., regarded as sources of revenue for the rulers. Regalia included many rights and prerogatives, for which see below. p. 161.

During the continuous warfare prior to the Peace of Westphalia (1648) cities and country districts were depopulated, while heavy loads of debt were accumulated by sovereigns. Torn by internal dissension, overrun by Turk and Frenchman, outstripped in trade by the vigorous activity of Holland, France, and England, there was need of action. The need of remedies was especially felt after the Thirty Years' War.

Kameralism became a study or discipline for training officials, largely for the work of remedying the economic evils which afflicted the German states in the sixteenth and seventeenth centuries.

In this situation, coupled with an undeveloped system of taxation, lay the roots of the German Mercantilism.

Beginning about the middle of the sixteenth century the rise of ideas characteristic of German Mercantilism or Kameralism may be traced in the thought of Luther and of Ossa (1506–1556). But Georg Obrecht, who was made professor of law at Strassburg in 1575, appears to be the first real Kameralist, with Besold — also a law professor — following. Bornitz and Klock (1583–1655) came shortly after, and are more important. These writers generally emphasized the importance of money and a dense population, and placed great confidence in government regulation; while they differed on such points as the advisability of depending on domainal revenue to support the government, the nature and scope of regalian rights, and a reduction of the legal interest rate. Chapters on such technological subjects as fishing, agriculture, the silk industry, etc., were often presented.

Better known and more influential than any of the preceding was Seckendorf (1626–1692), the author of *Der teutsche Fürstenstaat* (1655). He may almost be called the father of Kameralism. Like his fellows, he favored a dense population and restriction of exports; but he opposed gild monopolies and was more moderate in his views on government restriction. His tendency to separate economic considerations from those of a political or merely fiscal and administrative character is noteworthy.

To be associated with Seckendorf are Bechers (1635–1682), Hornig (or Hörnigk), and Schroeder (1640–1688); while with Gasser, Daries, Dithmar, Zincke (1692–1768), and Justi (d. 1771), Kameralism became a university study and was more systematically developed.

2. The Economic Thought of Some Typical Kameralists. — a. *Bechers' "Political Discourse": 1667.* — In the fore part of his *Political Discourse*[1] (1667) Dr. Johann Joachim Bechers gives us a statement of the rules which should regulate the various orders of society in Mainz, — the upper classes as well as merchants, artificers, the poor, Jews, and beggars. The quality and price of goods were to be regulated, forestalling prohibited, and, in general, the late-medieval market and handicraft regulations enforced. The authority of the gilds, however, must be decreased, and if a workman were skillful, he might work at his craft whether fulfilling gild requirements or not (pp. 71–83). He recommends that the three productive classes, merchants, handicraftsmen, and peasants, should be guided by one head official to the end that they might coöperate, and so cause the community to grow by advancing its business. "But, because . . . this consists in negotiation and sale, it is easily to be understood that of everything which hinders it or the business and population which arise from it, and on that account weakens the community and its business and all the utilities which result, nothing is so obstructive as to burden merchandise and merchants with high tolls and imposts; for thereby will the tradesman be impelled to furnish his wares dearly in order to cover such imposts" (p. 99). As a result, either foreigners would get the trade, or the consumption would be decreased and trade weakened. So with handicrafts: heavy taxes on the means of subsistence make artisans charge more for their work, and purchases are made abroad, while these results cause the agriculturist to lose his market.

Consumption or sale[2] is most necessary to hold the three groups together and bring prosperity. When the market is good the merchant sells, the manufacturer works day and night making things for the merchant to dispose of, and the agricultural worker produces raw materials. But the merchant is the keystone. Upon him and his sales rest the nourishment and increase of the people.

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[1] *Politischer Discurs, von den eigentlichen Ursachen des Auf und Abnehmens der Städt, Länder, und Republicken, in Specie, wie ein Land volkreich und nahrhafft zu machen.* (3d ed., Frankfurt, 1688; 1st ed., 1667; 6th ed., 1759.)

[2] "*Consumption, debit, oder Verschleiss.*"

"Those are proper traders who through their stock bring it to pass that raw stuffs remain in the land and are worked up by the subjects thereof, . . . that instead of foreign manufactures coming into the land and money going out to pay for them, not only does such money remain in the land, but the exports draw in trade (or wealth): These, say I, are useful members of the community" (p. 103).

Markets are of two kinds: domestic and foreign. The former is a *privatum privilegium,* is certain, and to be kept for home traders. The foreign market, if the foreigners are clever, is not to be hoped for as a *privilegium,* and one can draw away the foreigners' money only by the cheapness and goodness of one's wares. To this end, cheap living through low import duties on food, etc., is desirable; also, encouragement to good artificers, and good masters and materials.

Bechers makes much of three great evils: *monopolium, polypolium,* and *propolium.* These tend to destroy the state. The first, or monopoly, destroys population by restricting access to trade, as do the gilds with their many requirements. On the other hand, Holland, by abolishing all restrictions, has brought on a "polypoly" which exists when there are more peasants than land, more handicraftsmen than work, more merchants than market. This destroys subsistence. The idea of a "propoly" seems less distinct, Bechers himself stating that it tends to monopoly. The East India Company was a "propoly." To forestall or to take advantage of a cheap year to buy up for the purpose of selling dear at a later time also fell under this head and tended to destroy the community.

To Bechers the institutions of greatest advantage to a state were a well-established currency, a free market house (*Kauf-*

haus), a well-manned factory (*Werkhaus*), and a rich bank (p. 267). The first three would maintain the supply of money; the last would bring in more from abroad.

He seems to have had some understanding of the principle now called Gresham's Law, and discusses the measures tried by Sweden, Holland, and England for retaining their good coin.

As no ware is dearer or more necessary to a country, he lays it down as a general rule that by every means money should be kept at home, and to this end advocates a 5 per cent impost on specie exports. Coins should be of pure metal, but might be advantageously decreased in weight. By the establishment of exchange banks on the borders of the country, the flow of precious metals in and out of the country might be controlled, — only domestic coins to pass current within.

Bechers wrote much concerning foreign commerce, and favored developing it through the agency of regulated companies.

On the whole, though he did not overlook the importance of agriculture, nor desire an overdense population, he was decidedly a Mercantilist.[1]

b. *Hornig; Rules for Making a Nation Self-Sufficient: 1684.* — *Oesterreich über alles, wann es nur will* [2] is the title of von Hornig's (or Hörnigk) book. It was one of the best known of the Kameralistic writings, though now quite rare. The title strikes its keynote, — Austria above all if only she will. By systematically exploiting her resources, developing thrift, excluding certain foreign manufactures, etc., she might surpass her neighbors in power and wealth.

Hornig makes "the might and excellence of the land consist in its overplus of gold and silver and all other things requisite or convenient for its subsistence, and indeed all such as, in so far as is possible, come from its own resources, — and at the same time their proper (*rechtmässig*) care, use, and application" (p. 33).

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[1] Bechers seems to have given up some of his Mercantilist doctrines and to have displayed communistic leanings in his later years.

[2] Ed. of 1707 quoted; 1st ed. in 1684. For English translation and biographical note see Monroe (Ed.), *Early Economic Thought.*

This passage brings out the chief point in Hornig's thought: self-sufficiency. He accordingly proceeds to examine Austria's balance (*bilancia*), considering first her deficit, so to say, in gold, silver, and other things, and then her surplus; concluding that her great natural resources in salt, bread, fish, wine, etc., made it possible for her to increase production and secure a favorable balance (Chaps. xi, xii, xiii).

His idea of wealth and of favorable balance is not a narrow one. A land having only gold and silver is indeed rich (*reich*), but is far from the goal of self-sufficiency; for its people can neither eat nor wear those metals (pp. 27–28). On the other hand, one having all but gold and silver, while it could stand alone longer, is also dependent; for, we are told, gold and silver seem indispensable to most men, and such a land would depend upon the foreigner's good will for the exchange of its goods for gold and silver.

In making a common comparison between the bases for the industrial success of Holland and England, Hornig uses a striking figure: Holland's gold magnet is stronger in attracting, England's in retaining, the precious metals (p. 30).

Thus the question with Hornig is always one of foreign comparison. He specifically states that power and wealth have become relative terms, depending not on the absolute quantities of power and wealth possessed, but on their relations to those of neighboring lands.

The analysis of economic categories is interesting. All matters useful for human subsistence are of two sorts: first there is the thing itself; and secondly there is the proper (or legal?) care and application, especially suitable arrangements for domestic and foreign industry and trade (pp. 27, 31). The former depends upon nature alone; the latter partly on nature, partly on human wishes. In the last analysis all the things themselves fall into two classes: (1) gold and silver, (2) all other things for nourishment, clothes, shelter, etc. Gold and silver are equal to all other things in value and use (*Werth und Nützen*), and are of quite another sort on account of their "civil use."

But to return to Hornig's thesis. He lays down nine "fundamental rules for a general national-economics." These rules were quoted by other writers, and exerted much influence. They are fairly typical of the dominant mixture of Kameralism proper and Mercantilism.

(1) The earth and all on and in it should be examined most accurately to learn how everything may be made most useful to the nation; and in all things which concern gold and silver no pains or costs should be spared.

(2) "All the goods which occur in a country and which are not used in their raw state should be worked up in that country as far as possible."

(3) For the execution of these rules people should produce raw materials as well as work them up. Thus it is important to regard population, and to keep men from foolish occupations; and by all devices to instruct and encourage artisans and handicraftsmen, taking instructors from abroad if necessary.

(4) Gold and silver once in the country should if possible be kept there; but they must not be stored up, but kept in constant circulation. Nor must they be invested in unprofitable works.

(5) The inhabitants of a state should seek, in so far as is possible, to satisfy themselves with domestic goods and forego foreign products.

(6) "Should the importation of foreign goods be necessary, they should not be paid for with gold or silver, but with exchange of domestic goods."

(7) "Such foreign goods must be imported in the raw state and be worked up in the country."

(8) In all industry it must be considered how surplus goods can be exported in finished form for gold and silver, and with this object try to drive trade even to the ends of the earth.

(9) It is not as a rule permissible that goods of which the state has a surplus be imported, even if possible to buy the foreign goods for less than the domestic.

Hornig thought the exclusion of imports easy and simple

(p. 125). By this means a market would be guaranteed to the domestic producer: "When money no longer goes to foreigners at least ten millions annually will remain in the land and turn to business capital (*Verlagscapitalien*); and the assurance of the market, with the accompanying certainty of profits, will encourage capitalists to loose their cash. The foreign artificers will be compelled through lack of work and bread to come to the father-land to seek both."

The restrictions of the gilds received considerable criticism, but he does justice to the good order enforced by them.

Von Hornig's contemporary, von Schroeder, entered public service in Austria in 1673 to conduct a factory (*Manufakturhaus*) according to Bechers' plans, and was later court financial councilor in Hungary. He is notable for his attack upon gild monopoly, and his advocacy of tolls, public loans, and the balance-of-trade idea.[1]

c. *Daries' First Principles: 1756.* — Passing over the several writers mentioned above, the work of Joachim Georg Daries must be considered. His *First Principles of Kameral Sciences* was published in Jena, 1756, about ninety years later than Bechers' book. Shortly before this time Frederick William I had become interested in this subject, and in 1727 had founded chairs of Economic and Kameralistic Sciences at Halle and Frankfurt-on-the-Oder.[2] This had given an impulse to further study, in which it is noteworthy that technology was emphasized.

In his preface Daries expresses indebtedness to Schroeder and Seckendorf, and refers to Dithmar, the latter being the incumbent of the chair established by Frederick William in Frankfurt. He proceeds to recite the objections then being made to the study of Kameralism: it was said to concern things which experience alone could teach, its subject matter was too complex for generalization, and some thought that only burghers or peasants should busy themselves about such matters.

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[1] *Notwendiger Unterricht vom Goldmachen* (1648); *De Ministrissimo* (1663); *Fürstliche Schatz- u. Rentkammer* (1686); *Disquisitio politica, vom absoluten Fürsten,* Schroeder spent considerable time in England, and was much influenced by English thought. On Schroeder see Erbik, *Wilhelm von Schröder.* (A "Separate" from the reports of the Royal Academy of Sciences in Vienna. Vienna, 1910.)

[2] These are often said to be the first professorships of political economy, but if they are so to be called the term "political economy" must not be given the full meaning it now possesses. Gasser was the incumbent of the chair at Halle.

After disposing of these prejudices, he proceeds to consider the sources of annual income, which are of two sorts: one fixed and calculable, the other the result of chance (p. 11). The former alone can be dealt with scientifically. It consists of (1) aptness in application of human powers, (2) acquired goods which can be of annual use. These form what he calls a Fund (*Fond*) or Capital (!). They make a surer source of income than skill.

His definition of the term "Capital" is suggestive: "We take it in the common sense to designate that earned property which we accept as enduring so that it proves effective annually for our uses" (p. 15).

Now, a prince may be regarded either as a man, or as a royal personage or sovereign receiving a royal income. From the latter viewpoint, "the capital or fund of the princely income is the wealth of the State and the subjects." But to obtain this income, the capital of the subjects must not be encroached upon. It is constantly stated that the well-being of sovereign and subject are inseparable.

Daries' division of Kameralism is interesting. First comes Agricultural or Rural Economy, dealing with the forces of nature and their adaptation. Here tillage and cattle-raising are the chief subjects. Next he places Urban Economy, studying the ways in which art aids nature in workshops and factories. Then comes Police Science or Polity (*Policei*). Here such matters as population, education, care of the poor, and stimulation of industry are treated, — in short, all arrangements of the state for increasing the annual income of the citizens. Finally there is Royal Economy, which concerns the income of the prince, and is Kameralism proper.

Polity or general police power (*Policei*) is clearly distinguished from religion and law. It deals with wealth. In so far as justice and religion aim at preventing poverty or increasing wealth, they belong with polity. The laws of polity must not contradict moral laws; they must determine only how morally-permissible things can be directed to increase the wealth of the state. By nature, men are free to do anything in accord with reason; but policy may restrict and limit this liberty.

"A regular polity makes good, and consequently rich, subjects, good and rich subjects make rich and powerful Princes" (p. 394).

In his chapter on town economy Daries makes an analysis of costs which is most interesting. The producer should investigate these carefully and see that allowance is made for (1) raw materials, (2) interest on the value of such materials till the finished good is sold, (3) the price of tools, and (4) their interest and depreciation, (5) labor, (6) interest on wages, (7) interest on buildings used, and (8) expenses of marketing, accounting, etc. When these items are established as a capital and the price received for the product replaces this capital with interest, the business is carried on with profit (p. 233).

On the whole, he subscribes to the doctrines of Hornig, but is much more liberal. He does not believe that gold and silver should never be exported, his rule being the following: "The export of gold and silver is only to be obstructed to the extent that it does not work to the good of the state. It is, on the contrary, an evidence of political shrewdness to give foreigners gold and silver if it is possible by this to further the well-being of the State" (p. 531). And he opposes restriction of trade; for it would be better to seek how to direct the production of the nation into the most profitable industries. As to the desirability of always exchanging goods for precious metals, he remarks that circumstances exist under which the mere exchange of goods for goods is more advantageous. One country has especial advantage for one industry, another for a different one. By exchange of their respective products both profit (p. 536).

On the point of population he was an orthodox Mercantilist. "All industries which provide means for nourishing more subjects in a country are useful to it." A dense population is all but made the source of the wealth of the state. It is not to be feared. *If order prevails* density of population increases the food supply and trade and the income of the prince; and it is important for defense.

The foregoing is all drawn from Daries' chapters on Agricultural, Town, and Police Economics, the greater part of which is given to semi-technological topics, such as beer-brewing, linen manufactures, tillage, and cattle-raising.

He concludes with a book on the real or proper Kameral affairs, in which he discusses the income and expenditures of the prince, laying down rules for administering them. Chapters on Domains and Regalia, or regal rights, are included.

3. Justi's Political Economy. — The work of Justi, entitled *Political Economy, or A Systematic Treatise on all Economic and Kameral Sciences* [1] (1755), may be regarded as the climax of pure Kameralism. In it the great mass of Kameralistic doctrines was summed up and organized. There is little that is new, however, save the analysis and classifications.

In the first place some further idea may be gained from Justi concerning the classification of the subject matter. Economic science, he states, deals with the maintenance and increase of the means of private persons; Kameral science does the same for governments. But Kameralism proper is administrative in nature; for the business of the ruler is twofold, embracing besides polity and economy — which maintain or increase the means of the state — Kameralism, which seeks to administer these means so as to promote the general well-being. The latter, in a word, deals with the prince's revenue, its disbursement, and the organization and administration of his political business. One great branch of study is *Oekonomie*, which might be interpreted as administrative economics. Under it fall (1) Management (or private economics), (2) Police, dealing with the conduct and sustenance of the people, and (3) Kameralism and finance, which take up the methods and materials of commerce, and measures for promoting it.

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[1] *Staatswirtschaft, oder systematische Abhandlung aller Oekonomischen und Cameral-Wissenschaften, die zur Regierung eines Landes erfordert werden.* See Monroe (Ed.), *Early Economic Thought*, pp. 378–399.

The three great essentials to a flourishing state are freedom, safety of property rights, and a prosperous industry. For increasing the wealth of a state, these means exist: increasing population, foreign trade, and mining. Justi says that with good government and prosperous industry no limit should be placed to the increase of population, a statement which, in its assumption, begs the question as later raised by Malthus. Though he lays great emphasis upon commerce and his balance-of-trade idea is pretty narrowly Mercantilistic, he does not overlook the importance of agriculture.[1] This was, in part, however, with the idea of procuring cheap food and low wages for laborers.

Justi is extremely inconsistent in dealing with the nature and increase of wealth, some juster ideas being mingled with the old errors.[2] Thus, at one point, he says that a land might be rich even if it had no gold and silver, and defines wealth as the supply of the comforts and necessaries of life. But again we are told that gold and silver are necessary for exchange, and so a land is not rich without them. And, finally, he steps over into statements that wealth equals the supply of money.

It is clearly pointed out that the interests of the merchants are to be distinguished from those of the government, their gain not always coinciding with the public welfare, though it may do so.

One of the most notable points in Justi's book is his body of rules for levying taxes. Briefly they are as follows:[3] —

(1) Taxes should be so levied that they will be paid willingly.

(2) They must not restrict industry and commerce by interfering with freedom of conduct, credit, etc.

(3) They must be levied with relative equality.

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[1] It is interesting to note that he refers to Vauban in another connection. Vauban, a French writer, thought agricultural labor most important. See below, p. 173.

[2] *Staatswirtschaft*, I, pp. 152–155 (2d ed.).

[3] *Staatswirtschaft*, II, pp. 309 ff.

(4) They should be sure and true, falling upon such objects as enable a certain and honest collection.

(5) They should be levied on such objects as will permit the least number of collectors' offices, and officials.

(6) They should be so levied as to amount and time of payment as to be most convenient for the subject.

Justi, in the third rule, considers both the benefit received from the government and the ability of the subject to pay. In this classification he anticipates to no small degree the famous canons of taxation laid down by Adam Smith.[1]

4. Regalian Rights. — In order to understand the foregoing references to regalian and domainal rights, and, indeed, a considerable part of Kameralistic writing, it is essential to grasp the significance of regalian or regal rights in connection with the evolution of economic thought. To the Kameralists such rights meant no legal theory, nor a merely political struggle between sovereign and pope or vassal, but the source of revenue. The regalian question, which reached its height in Germany in the seventeenth century, owed its significance largely to the backwardness of taxation and the taxation idea at a time when states needed more revenue. Dependence on the income from royal domains was no longer possible. Some middle source of revenue must be found. Hence there was a tendency to expand fiscal policies by extending the number and scope of royal privileges.

Roscher distinguishes four groups.[2] First, the various feudal aids and duties were exploited. Thus knight service might be escaped by a payment; large amounts were demanded when land was sold; and when traveling the king lived upon his people through rights of purveyance and preëmption. Secondly, there was a group analogous to domainal rights. For example, all property without an owner might revert to the king; buried treasure and the property of deceased aliens were his; etc. Then another source of revenue lay in the political activity of the sovereign: he shared in war booty, sold offices and protection, and received fines and confiscated property. Lastly, the state conducted directly or indirectly certain industrial enterprises, especially new trades, and industries in new lands. So it was with the post, lotteries, mining of precious metals, and certain branches of foreign trade. In this last case, and in the third, too, political objects may have been partly in mind. Altogether as many as four hundred regalian rights were sometimes distinguished.[1]

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[1] Below, p. 228.

[2] *Geschichte der Nationalökonomik in Deutschland*, p. 159. These are not of fundamental importance, but are useful as giving a summary idea of the scope of regalian rights.

Now this mass of sovereign rights was rather chaotic and ill-defined. In keeping with the Kameralist's confusion of political, financial, and general economic matters, regalian rights appear to have been regarded as a sort of middle ground between domainal revenue on the one hand, and taxation proper on the other, and came to include an unanalyzed mass of tolls, duties, aids, and taxes which did not seem to them to fall under either of the other heads.

It has been suggested that this is a normal stage between what from a fiscal point of view may be called domainal and tax economies.[2] On the political side this stage corresponds to a transition period between feudalism and absolutism, its later phases being characterized by an extension of the prerogatives of the crown and the decay of the old nobility, while systems of taxation authorized by class or mass had not yet been established.

It remains to be noted that some of the later Kameralists took steps toward an analysis and delimitation of regalian rights.

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[1] In England Blackstone divided regalian rights into two groups: *majora regalia*, which embrace the prerogatives that concern the political character, the dignity, and regal power of the sovereign; and *minora regalia*, which concern the regal revenue. He tells us that the English kings had been shorn of much of their revenues, having granted them away to subjects; yet he distinguishes eighteen varieties, such as the revenue from bishoprics, rights of purveyance, rights of royal fish (whale and sturgeon), forfeiture and escheat, etc. These are the "proper patrimony of the crown," though English kings were largely dependent upon extraordinary revenue. (Blackstone's *Commentaries*, Bk. I, Chaps. 7 and 8.)

[2] Roscher, *Gesch. d. Nationalökonomik*, p. 158.

Justi classified them under four heads, as concerning highways, water, forests, and sub-surface wealth; while Sonnenfels went further and cut down the extent of these rights considered as fiscal devices by placing mine, salt, and tobacco regalia under taxation, and classing others as aids to *Polizei* or police power. Rau, however, clung to the old classification.

This tendency, though the source of considerable contention in its details, is in general logically necessary. The regalian rights lost their significance with the limitation of royal prerogatives and the growth of taxation. All that was left fell logically either under taxation, or under tolls and duties imposed for the control of consumption and the like.

5. Kameralism and Mercantilism; Summary. — Kameralism might be defined as German Mercantilism.[1] Like Mercantilism, it is difficult to define comprehensively as a body of thought. This much must·be stressed: it was more than English Mercantilism. The representatives of both groups made much of government regulation, placing a naïve confidence in the efficacy of laws. Tariffs and taxes figured prominently. Both regarded the precious metals as the most desirable form of wealth, emphasizing their distinctness. Both were animated by international rivalry, and both preached dense population, frugality, and self-sufficiency. But there the main points of similarity begin to cease.

A notable difference in the form and scope of the writings which contain the views of the two groups strikes one at a glance. The English Mercantilists were pamphleteers, writers of short tracts, not very comprehensive. The German writers set forth their doctrines in bulky volumes, dealing with all phases of their topic as they conceived it, and with much show of logical sub-division and arrangement. They were professors of law, finance councilors, and the like.

The German works, too, form part of a more connected body of thought. With their roots in medieval treatises and Roman jurisprudence,[1] the fruit of more modern German economics is in part theirs; for Kameralism, unlike Mercantilism, existed as such into the nineteenth century.

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[1] Remembering that Mercantilism must not be too narrowly confined to certain ideas concerning balance of trade and estimation of money.

The Kameralists, with a few exceptions, were relatively less concerned with foreign relations, commerce, and the balance-of-trade idea than their more maritime neighbors in England and France. They made more of internal or domestic industry,[2] and to this end incorporated in their writings books or chapters dealing with the technology of agriculture, grazing, mines, and forests, and the various branches of manufacture. These subjects received little attention from the English Mercantilists.

This last difference is to a considerable extent the expression of different origins and objects. Kameralism began with the desire for efficient administration of the domains and regalian rights of the sovereign; and it retained the stamp of its beginning to the end. Kameralism embraced many things, but its proper part was ever the maintenance, increase, and expenditure of the prince's income, by which was meant the revenue of the state. As in the case of English Mercantilism, the interests of state and individual were *not* assumed to be in harmony. The German state, however, was somewhat different from the English state in the absolute nature of its prince's rule, so that politically Kameralism is more like Colbertism than English Mercantilism.

Moreover, the wasting and depopulation of town and country caused an unusual emphasis to be placed upon population; while the exhaustion of treasuries meant an equal attention to fiscal devices.

There is some difference of opinion as to the merits of the Kameralistic ideas about population. While the needs of their country were such as to make a problem different from that which later confronted Malthus, and while their qualification that order and good government must prevail should be remembered, yet it must be concluded that they often stated the benefits to be expected from an increase in population too absolutely. At points there seems to be a kind of optimism in their thinking. They were prone to assume that the other factors would develop in proportion. Sometimes, too, population was thought of almost as an end, — now for military purposes, now as an economic benefit. The chief criticism, after all, is that they did not go far enough in their thought, the result being a short-time policy rather than a general theory. Here, as elsewhere, we may judge leniently, but remembering that this is done not so much because these early thinkers had the truth as because they *were* early thinkers, and so our standard itself may be modified.[1]

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[1] Bornitz, for example, constantly cites the *Corpus Juris*. Seckendorf's *Der teutsche Fürstenstaat* appears to be the first book (1655) on political economy written in German, the other Kameralists using Latin.

[2] Even of Hornig, Oncken says, "One sees that this German Mercantilism has its climax not in foreign trade but in domestic."

The importance of a knowledge of Kameralism to an understanding of German economics remains to be observed. Without its peculiar background of *Kameralwissenschaft* German theory would probably have been other than it is. One of the most obvious effects of Kameralism appears in the division of the science into general and special economics, and finance; and in the emphasis on the technical and financial aspects. Again, the early prevalence of a distinction between public and private interests, and the general recognition of the importance of legal advantages, special privileges, business arrangements, etc., and also of credit, may be traced to Kameralism. One cannot but be struck, too, with the similarity between the ideas of the Kameralist Daries and the economist Hermann concerning capital. In these and other ways, German economics was affected by its peculiar heritage.

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[1] I would agree with Professor Small when he says that the Kameralistic ideas have been misrepresented. Also in his statement that "they did not qualify their statements about population quite as carefully as men must who have in mind the Malthusian chapter in economic theory." But it does not seem to me correct to say as he does that "the cameralists knew as well as modern economists do that there was a limit beyond which more mouths could not be fed. . . . Substantially . . . they held tenable views of the subject as far as they went." (*The Cameralists*, p. 15.)

C. THE EVOLUTION OF ECONOMICS AS A SCIENCE

I. THE FOUNDERS

To one who turns from reading a modern treatise on economics, whether it be Mill's *Principles of Political Economy* or the works of Böhm Bawerk or Marshall, and takes up the various writings which have been dealt with in the foregoing pages, a great development is evident. Heretofore, economic thoughts have been gleaned mostly from books on religion, politics, or jurisprudence. At most, the sources have been rather sporadic pamphlets or essays, or treatises upon political and technical matters. Probably it would be misleading to say that these thoughts were unclassified or unsystematic. Some writings of Aristotle, for illustration, were truly scientific. In the works of the Roman jurists and medieval scholastics, economic ideas were fitted into organized bodies of thought. The point is that they were not distinct. They formed no separate science, but lay inchoate within other bodies of doctrine, — ethics, jurisprudence, and the like. Generally they were associated with practical questions of policy.

To found the science of economics, then, it was necessary to sever these scattered economic ideas and bring them together in a separate system of thought. For this step the way had been somewhat prepared, especially by the Mercantilists and Kameralists, who made considerable progress in giving economic ideas separate attention. It was not until the middle of the eighteenth century, however, that Economics was really founded as a science. To recount the circumstances under which this development was achieved and sketch the main features of the new science, is the object of the two following chapters, which deal with The Founders.

CHAPTER IX

THE PHYSIOCRATS AND THE REVOLUTION IN SOCIAL PHILOSOPHY

About the middle of the eighteenth century a group of French thinkers evolved a system of economic thought which forms one of the important roots of the modern science. One of their number styled that system "Physiocratie," and ever since these men have been known as the Physiocrats. The Greek words φύσις and κράτος signify the rule of nature, the system of thought now under consideration being based upon a belief in the existence of natural laws which must be followed if men are to gain their highest well-being. This system was also known as the Agricultural System, and is so called by Adam Smith. The Physiocrats liked best to call themselves "The Economists" (*Les Économistes*).

The leading Physiocrats were affiliated with a school of philosophers, who, while differing on many points, were generally agreed in holding that all things are part of an interconnected system, proceeding from a common cause and governed by laws which are capable of human comprehension. These thinkers more or less consciously wrestled with the problem of reconciling mind and matter, and found their easiest point of attack to lie in the assumption of some supernatural power. They were prone to appeal to "Nature" or "Divinity" as a means to bridging the seeming gulf between the ideal and the material.

Accordingly, inasmuch as they assumed the ultimate cause, they did not stop to establish by research their premises, but rapidly deduced such a connected series of doctrines concerning social life and industrial organization, that they may be called the founders of the first system of political economy. They regarded the "social order" — note the phrase — as paralleling the physical order, and as being similarly subject to uniformities, or laws. They endeavored to include all the social phenomena connected with the production of wealth, embracing in their economics laborers, manufacturers, merchants, farmers or agricultural entrepreneurs, owners of large estates, and sovereigns. Thus the new teaching, whatever its faults, was much more comprehensive and systematic than Mercantilism, which was but fragmentary and emphasized foreign trade in a narrow fashion. It should be noted at the outset that the Physiocrats, in view of the industrial situation which confronted them in France, — and perhaps their own interests as landowners — turned their attention largely toward agriculture, and regarded taxation as their chief practical problem.

The Forerunners of the Physiocrats. — Mercantilism has been described as embracing the group of economic and political doctrines which prevailed among the statesmen and political writers of the sixteenth and seventeenth centuries. It held sway on into the eighteenth century; but toward the end of the seventeenth protests against the extreme doctrines of that system had begun to be uttered even in its stronghold, England.[1] It is little wonder, then, that in France, a country more easily led into revolt, the abuses which attended and followed Colbert's régime soon brought on a violently negative economics. Physiocracy, though it meant much more — and had several motives — might also be defined as the revolt of the French against Mercantilism. This revolt, however, did not break out in any organized way until the middle of the eighteenth century, and a word should be said about the economic thought which intervened, — about the forerunners of the Physiocrats.

Melon (*Essai politique sur le commerce*, 1734), although in the last analysis a Mercantilist, was full of contradictions, and may be regarded as a transitional writer. He believed, however, that necessaries of life are of more importance than gold, and reacted somewhat against paternalism and monopoly.

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[1] By Barbon, Child, Locke, and others. See above, pp. 122 f., 123, 133 f.

The first economic theorist of note to be produced by France, however, was Pierre Boisguillebert. Although an unsystematic writer, Boisguillebert in his thought on many points seems to foreshadow the later school. He was a contemporary of Colbert's, and his work was stimulated by the misery which followed the financial abuses of Louis XIV's reign. Tax reform, then, was the burden of his first book,[1] equality in distribution and abolition of export duties on grain being the chief demands. Two essays were later added, one a *Treatise on Grain* and the other a *Dissertation upon the Nature of Wealth.* They treated land as the chief source of wealth and were written in the interest of the landed classes, containing arguments in favor of high prices for grain. In them he refers to Holland, Henry IV, and Sully,[2] praising the latter at the expense of Colbert. Quite significant was his attack upon the overvaluation of precious metals: wealth to him consisted rather in the supply of necessary and convenient things which satisfy man's many different wants. Such wealth seemed to depend, not upon political policy, but upon a natural harmony of industry.

Contemporaneously with Boisguillebert another Frenchman was driven by the same unhappy industrial state of his country to think similar thoughts. In 1707 Marshall Vauban published his *Project for a Royal Tythe.* He described the wretched condition of the peasants, which he, too, attributed largely to inequality in taxation. His project included a direct tax of one tenth of the product of agriculture. He would have permitted domainal revenues, some customs duties, and a few duties on consumption, but on the whole may be regarded as a pioneer of a simple system of direct taxation in which a heavy tax on land revenues was an important part. Vauban considered labor as the foundation of wealth; and of all labor, that in agriculture seemed most important.

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[1] *Détail de la France sous le règne présent*, 1695; this was enlarged by the addition of the dissertations on *Grains* and *Richesses* and published as *Factum de la France* in 1707.

[2] Sully had said, "Labourage et pasturage sont les deux mamelles de l'état," — tillage and pasturage are the two breasts of the state.

Fénelon (*Télémaque,* 1699) in favoring freedom of trade and emphasizing the character of the people rather than their numbers; and Montesquieu (*L'Esprit des lois,* 1748) in holding that "natural laws" obtain in the social world and arguing for liberty, are also worthy of mention in making the transition from Mercantilism.

But most noteworthy of all is Richard Cantillon. Indeed, his *Essay upon the Nature of Commerce in General,*[1] published in 1755, may justly be called the forerunner of the science of political economy, for it is a general treatise and inquires into principles. Wealth he defines as being nothing other than the comforts and conveniences of life. The earth is the source or material whence wealth is drawn; labor is the force which produces it. The great merit of Cantillon's essay lies in its attempt to trace the circulation of wealth. He deals with internal trade between town and country, thus taking the sole emphasis away from foreign commerce. He argues that in a country where one half the population lives in towns, one half the agricultural produce must be consumed by the urban dwellers; and proceeds to discuss the distribution of that produce between landowners and farmers, and to analyze the expenses of the latter. Cantillon also discusses value and price, following Petty in basing them upon the amount of labor and land which contribute to produce the thing under consideration; but he goes on to reduce the value of labor to the produce of land required for the support of the laboring population. His manuscript work was circulated in France and must be accounted an important factor in shaping the thought of the Physiocrats.

Of all the preceding men it may be said that, while they were to a greater or less extent opposed to Mercantilism, they were limited by it, and they founded no opposing system of economic thought. Cantillon comes nearest; but he seems to have held Mercantilistic ideas concerning the balance of trade, and, as a banker, his point of view was rather different from that of the Physiocrats.

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[1] See reprint for Harvard University, G. H. Ellis, Boston, 1892. Originally written in English, the essay was translated by Cantillon for the use of a French friend.

The Forces Which Gave Rise to Physiocracy.[1] — The condition of France which stimulated the writings of Boisguillebert and Vauban long remained without reform, and is to be regarded as first among the factors which gave rise to Physiocracy. When one calls to mind the reigns of Louis XV and Louis XVI, during the time which immediately preceded the French Revolution, one remembers at once the main features of the situation. Louis XV was the last to exercise without restraint the royal power in France. He was the center about which everything else was made to move; outside of him there was no state. The consequences of the royal maxim, "L'etat c'est moi," — I am the state, — were far more injurious to France under him than under the régime of Louis XIV. Court life was degenerate and corrupt. It was taken up with pomp, extravagance, and debauchery. The women of the court interested the king far more than the national welfare.

An exhausted state treasury and increasing debts were the result of a luxurious and extravagant mode of life and unnecessary wars. To replenish the treasury, loans were made under unfavorable conditions. Taxes were heavy, and disproportionate rates were paid by peasants and commons. The nobles and clergy, who owned some two thirds of the land, were nearly exempt from direct taxation, while a variety of taxes oppressed the lower classes, — duties on goods passing from one province to another, the salt tax, the poll tax, the tithes, etc., not to speak of the services and burdens of the feudal system. But the worst feature connected with the taxes was the manner of collecting them. As one rents a farm with the intention of cultivating it so as to draw from the soil all that it can possibly yield, men, called farmers of the revenues, contracted for the taxes at a fixed price. All that they collected over and above that amount was their own, and so excellently did they understand how to exploit the people that they scarcely left them the necessary means of subsistence, while they themselves frequently retired with fortunes after a few years.

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[1] Weulersse, *Le mouvement physiocratique en France* (Paris, 1910). See also Ware, "The Physiocrats," *Amer. Econ. Rev.*, XXI, 607–619.

Land values were reduced, or kept from rising. The poor *métayer*, after paying the landowner a large share of his produce, was heavily taxed on the remainder; while the value of that remainder was reduced by duties which restricted markets at home and abroad, these restrictions being in sympathy with the Mercantilist policy of lowering wages and other expenses of manufacture so as to enable the country to export merchandise.

In short, France was like a great railway or factory which has made no allowance for depreciation or depletion; her productive power was impaired and her credit shaken.

On the other hand, the Mercantilist policy had exhausted its resources and had outlived its usefulness. The passing of its power in England was evidenced by Cantillon's *Essay*, with its emphasis on domestic trade and its tendency to regard the landowner as the only independent producer. But in France, government supervision kept on in the same old ruts, until it came to be recognized by the thoughtful that trade and manufactures had been unduly fostered at the expense of agriculture.

In England an agricultural revolution was being consummated.[1] The profitableness of farming on a larger scale, with more capital and rotation of crops, was known to the Physiocrats. In fact, Quesnay, their leader, was personally interested, and applied the new methods on his own estate. These facts would further shake the prestige of Mercantilism and turn men's thoughts toward the importance of agriculture. Moreover, the emergence of a new commoner class of landowners, of whom Quesnay was one, lent the support of a selfish interest in land values.

Finally, there were great subjective forces at work for change and progress. The evil state of affairs just described, coupled as it was with injustice and oppression, would ordinarily have given rise to immediate discussion and criticism. Under Louis XIV, however, this result was prevented by the wonderful ascendancy of the king and his dazzling military policy; while his successors took the most severe measures to stamp out writings hostile to the government.[1] French thought, too, was but beginning to break away from the shackles of servile credulity, first as to religion, then as to politics. Toward the middle of the eighteenth century, in spite of oppression, this emancipation was rapidly effected. Notable changes had just been made and were being made in philosophy. Political writers were beginning to speculate about more rational and simple laws which would be based upon general principles of justice. The ferment preceding two epoch-making revolutions was in men's minds, a ferment tending toward the emergence of the individual as the center of philosophy and politics. It has been noted in Montesquieu. The last remnants of medieval credulity were crumbling. The natural sciences were making great strides, and there was a tendency to apply their methods to philosophy and social problems, seen, for example, in Hume and Descartes.

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[1] See Toynbee, *Industrial Revolution*, Chap. III.

England and English thought were practically unknown to the France of Louis XIV.[2] In the two generations which followed that monarch's death "there was hardly a Frenchman of eminence who did not either visit England or learn English."[3] Among them were Montesquieu, Gournay, and Mirabeau. The work of Newton was popularized; the philosophy of Locke became widely accepted; and the thought of Shaftesbury and Hume worked as a subtle leaven. Even more directly to the point, several English books on economic subjects were translated into French, among these being works by Gee, Child, Culpeper, and King (*British Merchant*).

General Outlines of the Physiocratic Political Economy. — a. *Nature Philosophy.* — In order to understand the political economy of the Physiocrats it is necessary to grasp clearly their underlying philosophy. And in the first place come their "natural order" and laws of nature. Although there were some considerable differences among them, they followed Rousseau and the ideas of the time to the extent of believing in an ideal order of things, whose arrangements were perfect and whose laws were the will of God. This was the *ordre naturel.* It stood opposed to the *ordre positif*, whose laws are human and whose arrangements are the imperfect ones of existing governments, in this resembling the distinction made by Thomas Aquinas and ancient philosophers before him. In their teachings they sought to expound the principles of the *ordre naturel,* that nation being best governed whose laws, or *ordre positif,* come nearest to expressing the constitution of the natural order.

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[1] See Buckle, *History of Civilization*, General Introduction, Chap. XII.

[2] *Ibid.*

[3] *Ibid.*

The natural order of society, however, is not to be confused with the "state of nature," for it is founded upon law and property rights. The Physiocrats, therefore, were far from adopting the conclusions of Rousseau. Quesnay, who, as will appear, was a leader, said that in the state of nature the *ordre naturel* is indeterminate.

It is easily possible to exaggerate the importance attached by the Physiocrats to the divine character of the *ordre naturel.* To be sure, one Physiocratic writer says that "the social order (*ordre naturel et essential de la société*) is not the work of man, but is, on the contrary, instituted by the Author of all nature himself, as all the other branches of the physical order." [1] But that it is not the work of man is to be noted; and above all that it is a part of the physical order. Another writer makes the following striking statement: "But to discover the causes and effects of the diversity of revolutions; to search out the simple forces whose action always combined with, and sometimes disguised by, local circumstances, directs all the operations of commerce; to recognize those special and fundamental laws, founded in Nature itself, by which all the values existing in commerce are balanced against each other, and settle at last into a fixed value, as bodies left to themselves take their place according to their specific gravity — this is to approach the subject (of commerce) as a philosopher and a statesman."[1]

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[1] Mercier de la Rivière, *L'ordre naturel,* p. 38.

Certainly, the significance of the Physiocrats' philosophy in leading up to the idea of general principles or social laws should not be overlooked. They ~~believed that~~ men in society are subject to natural laws in the same way that the equilibrium of nature is maintained by physical laws. These natural laws of society are the conditions upon which depend well-being. As Dupont de Nemours put it: In general, natural laws are the conditions essential, according to which all the phenomena of the world occur. In particular, that part of the natural law which is relative to man comprises the conditions essential to the assurance of all the advantages which the natural order can afford. These conditions "determine the use which we ought to make of our faculties in order to be able to satisfy our needs, to enjoy to the fullest extent our natural right . . . ," etc. Influenced by contemporary developments in the natural sciences and by the philosophy of Locke, Descartes, and Malebranche, the Physiocrats first conceived that the production and distribution of goods are carried on according to fixed laws of nature, and then attempted to deal with the problems of distribution much as if they were problems in physics. ✓

The real general criticisms of this part of the Physiocrats' philosophy appear to be that (1) they did not make clear and definite what they meant by their *lois natûrelles* and *ordre social*, and (2) in applying their ideas they fell into an erroneous absolutism of theory. Quesnay in discussing *droit naturel* merely says that justice is a sovereign rule to be recognized by the light of reason, which determines what pertains to oneself and what to others;[2] and Dupont de Nemours vaguely adds that the laws of the social order embrace all the relations of which men are capable, deciding by the evidence of their reciprocal interests what their conduct toward their fellows should be for their well-being.[1] There was much talk of "rights" based upon the inherent nature of man. Perhaps because of this lack of clarity and definiteness, the Physiocrats were led to put their ideas in a very sweeping way, and thus became liable to the charge of "absolutism" in their theories. They were continually referring to "immutable" laws; and, by assuming that their theories were founded on the nature of things, they made it impossible to reason effectively concerning causes. As already noted, to attempt to explain social institutions by saying that they are "natural" is but little if any raised above the metaphysical notions of the ancients.

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[1] Turgot, *Éloge*.

[2] *Droit naturel*.

Had the physical sciences, and especially biology, been more highly developed, a different story could doubtless be told, for the Physiocrats clearly saw the interrelation between the physical and social worlds, and were inclined to emphasize material factors. But the science of biology was hardly even in its infancy, and they were dominated by metaphysical conceptions concerning innate and eternal ideas, the mind of God, and the like.

Following Locke, the Physiocrats emphasized the individual and individual "rights." Private property was justified on Locke's grounds: it is the expression of individuality, to which it is essential. Moreover, they believed that the individual should have a large measure of freedom in disposing of his property. But it must not be thought that they advocated an unlimited individualism, for that the rights of each limited the rights of the other, was clearly seen.[2] The freedom of the foolish man must in some instances be restricted by the state.

The most influential writers among the Physiocrats proper believed that the individual knows his interests best or, in other words, that individuals tend to act more in accordance with the law of nature than government. *The basis of their whole economic*

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[1] *La physiocratie, discourse préliminaire.* Note that the sanction is rational — not divine nor metaphysical.

[2] Quesnay said a law of individual action consisted in "de faire son sort, le meilleur qui lui soit possible sans usurpation sur le droit d'autrui." (Oncken, "Quesnay," in Conrad's *Handwörterbuch.*)

system may be truly said to lie in the principle of self-interest. They assumed that the individual calculates advantages and disadvantages and recognizes the necessity of coöperating with his fellows, — on these assumptions they based their theory of society.

Hence their well-known maxim, *laissez faire, laissez passer,* that is, let things alone, let them take their course. The only function of government according to this doctrine is to protect life, liberty, and property.[1] Since liberty and property spring from the very nature of man and are necessary to his individualism, human laws should merely recognize, formulate, and maintain them. (Those who did not adopt or express the principle of individual self-interest, merely assumed that the social order is governed by laws. These must be observed; therefore, *laissez faire.* Thus the let-alone principle united both the materialistic rationalists and those idealistic Theists who believed that God rules the universe, including economic life.)

The conception of a great harmonious law of nature carried out through individual action is evidence of an exceedingly great optimism. Indeed, optimism has been a marked characteristic of French economics down to this very day. We find Mercier de la Rivière writing [2] that it is the essence of the *ordre naturel* of society — why, he does not say — that the particular interest of the individual can never diverge from the interest of the community as a whole, and that this is proved (*sic*) by the good effects arising from freedom of industry and commerce. Self-interest, he says, encouraged by freedom, actively and perpetually presses each individual to multiply the things which he sells and thus to increase the enjoyments available for all.

With such an underlying social philosophy the Physiocrats sought to find the causes for the economic evils which afflicted France. Their predecessors, the financiers, had been content to experiment with taxation and money; "The Economists," however, found a critical symptom in the poverty of the people as is indicated in their celebrated maxim, "poor peasants, poor kingdom; poor kingdom, poor king."

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[1] Some of the Physiocrats favored a monarchical form of government as the one which could most easily enforce their reforms, but the duties of the monarch were merely to give effect to natural law. They were advocates of what is known as "enlightened absolutism."

[2] *L'ordre naturel,* last chapter.

b. *The Produit Net; the Physiocrats' Ideas on Surplus.* — But the peasants' poverty meant a lack of prosperity for the agricultural classes and this, together with their nature philosophy, the influence of such writings as Cantillon's, their reaction against Mercantilism, and perhaps an unconscious bias arising from their leader's ownership of land, caused them to lay great stress upon agriculture. Only agriculture, they said, including mining, fishing, and other extractive industries, is able to increase the wealth of a nation. In agriculture, nature labors along with man, *by her bounty yielding not only what the agricultural laborer or farmer consumes, but also a surplus which nourishes the other classes of society.* The land, or agricultural labor, — both ways of putting it are found, — produces more than enough to satisfy the needs of the laborers in agriculture, and the excess allows commerce and the professions, favoring population and animating industry. (Each cultivator was assumed to produce enough for eight persons, comprising his own family of four, and one family belonging to the manufacturing, commercial, or proprietary class.[1]) Thus the Physiocrats introduced the idea of a surplus due to the bounty of nature.

This unique surplus was called by them the *produit net*, or net product. The basic idea was that land produces so much material that the total product suffices not only (1) to support cultivators, artisans, merchants, etc., and replace buildings, tools, etc., but also (2) to yield a surplus for land owners and the sovereign. This idea was developed so as to be somewhat similar to the rent doctrine of the Classical Economists,[2] as the net product was sometimes regarded as the value of that part of the total produce of extractive industry which remained after deducting the wages of the labor, and the replacement charges and interest of the capital which helped produce it. It was no small contribution to the development of economic analysis that the Physiocrats made in bringing out the two facts, first, that the return to land differs essentially from the return to other productive agencies, and, second, that the return to land is something in excess of cost (including profits).

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[1] *Œuvres de Quesnay* (ed. Oncken), Tableau, p. 320.

[2] See below, pp. 294 f.

Commerce and manufactures were regarded as non-productive. They enhance the value of the raw materials which form the basis for the *produit net*, but only enough to pay for the labor and capital used in the process. Thus if a carpenter makes a chair from a piece of lumber, the whole difference between the value of the chair and that of the lumber is the compensation of the carpenter. No surplus remains for any one else. "The cost of commerce," wrote the Physiocratic leader, "although necessary, ought to be regarded as a burdensome expense levied upon the revenue of the landed proprietors"; and the Physiocrats held that a nation which depends upon manufactures and commerce must live off its capital.

It will be observed at once that this reasoning involves a peculiar definition of the word "production." To the Physiocrats production meant surplus making; that industry is productive which *increases* the wealth of the nation by making more things than are consumed in the process. If this definition be borne in mind, their doctrines are more easily understood, and do not seem so absurd as when the illogical attempt is made to apply our definitions to their words.

But more than this, to them production meant stuff making, and their surplus meant primarily a material surplus. The majority of them thought, or implied, that by growing wheat a man added to the wealth of the nation more than he did by making bread out of the wheat.[1] Only the growing or catching or digging up of something seemed to *increase* the world's stock of "real" wealth. This idea of productivity and the nature of wealth was in keeping with their nature philosophy, and was an expression of their reaction from Mercantilism. They saw that money was not the most important thing; but they went too far in their distinction between natural and artificial wealth, and in the corresponding distinction between the net productivities of those who produced the two.

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[1] This does not mean that their physics was wrong and that they violated the principle of conservation of matter. Some cruder utterances might imply this, but their real fault lay in denying a surplus to manufactures and commerce. This error is based on faulty psychology rather than bad physics.

In accord with the foregoing views, the Physiocrats added to their demand for industrial freedom another for an increased application of capital to land: by devoting more to agriculture, and by leaving industry free to obey the laws of nature, both the suffering of the people and the deplorable condition of the public finances might be relieved. Thus the nation would cease to consume its capital unproductively.

c. *Value.* — With such a basis for their economics, it is not strange that the concept of value played but a little part in the Physiocratic system. Their attention, after all, was largely addressed to production. Although Turgot, for example, treats wages and interest to some extent as "shares" in a process of distribution, these are, on the whole, regarded rather as costs to the producer. (Taxation makes a possible exception to these statements.) This, coupled with their peculiar ideas about productivity, made distribution mean a circulation and division of physical products rather than a sharing of values. Moreover, the problem of labor *vs.* capital, and all the complexities of distribution in a freer and more advanced industrial régime, were rudimentary or absent.

Enough was written, however, to enable us to understand fairly well their idea of value, and to draw some conclusions as to how they thought value to be determined. On the whole, the Physiocrats did not regard value as inherent in things. While they seem to have considered utility as inherent in goods, they recognized the difference between utility and value, — as others had done before them. Goods or utilities (*biens*) were distinguished from wealth (*richesses*),[1] and value in use (*usuelle*) was differentiated from value in exchange (*vénale*). "Price," however, does not appear to have been kept distinct from the concept of "value," the two ideas being treated as one: "what is called value is the price." [1] Wealth, they defined as possessing exchange value.[2] Accordingly, the Physiocrats tended to exaggerate the importance of exchange value, not bothering their heads about intangible "personal worths," and gliding over the complications arising from different subjective values. Certainly they did not go deeply into the forces determining exchange values. Goods exchanged were considered of equal value, each one being the measure of the value of the other. Mirabeau wrote: "*le prix fait tout.*" [3]

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[1] Quesnay, Art. on *Hommes*, p. 42.

The way in which the Physiocrats thought exchange value, or price, determined, is not so clear. In general, their "value" was a market ratio of exchange, and might far exceed cost of production. Quesnay and the leading Physiocrats recognized a "*prix fondamental,*" which they apparently regarded as established by competition and based on average expense of production, but did not sufficiently explain. He and his followers were more interested in the fluctuations of the "*prix courant*" (market price). This, they said, depended upon the "rarity or abundance of production, or the more or less competition of sellers and buyers," [4] a demand-and-supply theory. Quesnay said that the value of exchangeable goods depends, not upon the labor expended to obtain them, but upon the extent of the market (*consommation*) and the number of those who desire it. At the same time, traces of an idea of a natural price, toward which competition tends to draw current prices, may be found. How this natural price level is determined, however, was not satisfactorily explained.

By Le Trosne [5] the general estimation or judgment is emphasized, and prices are fixed by competition which expresses it. This general or common estimation is the result of the coöperation of several factors, among which are the utility generally attributed to a good, the average indispensable costs, demand relative to purchasing power, and available supply.

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[1] Quesnay, Art. on *Impôt*, p. 58.

[2] Mirabeau, *Philos. rurale*, Chap. XXI; *Œuvres de Quesnay* (ed. Oncken), p. 353.

[3] *Philos. rurale*, Chap. XII.

[4] *Œuvres de Quesnay*, p. 388.

[5] *De l'intérêt social* (1777); Daire, *Physiocrates*, pp. 890 ff.

Turgot, in an incomplete essay, *Valeurs et monnaies*, states that an isolated individual values goods according to their utility, but in cases of equal utility he assigns different values according to the effort required to obtain them. In society, however, the valuations of the parties to an exchange may differ. Here the price will lie between the valuations of buyer and seller; and, with free competition, each gets a surplus.[1]

The logical analysis suggested by their ideas would be this: the value of a good is based upon its usefulness (utility); a manufactured article consists of two parts, one the original material, the other the energy expended in transporting and working it up; the value of the former, being in part the gift of nature, is determined by the ratio of its supply to the demand for it, while to this value must be added the subsistence of those who worked the article up into the finished form and marketed it.[2] The Physiocrats' whole philosophy of wealth made a recognition of the importance of utility essential, and its essentiality was clearly stated. It is obvious that their surplus, the *produit net*, could not have its value determined by cost. It was the gift of nature, and a surplus above cost.

As productivity was confined to the yielding of raw materials, value and productivity could not be coördinated on any basis of cost of production. It might have been held that natural value was conditioned by the amount of material contained, but this would not have explained the value of *richesses stériles*, the products of manufacture. Utility was common to all, but one part of the nation's sum of exchange values, or wealth, was effected without cost; another, only partly through cost. Half consciously, perhaps, this difficulty was passed over by virtually limiting the discussion to market values alone, demand and supply being left with little analysis.

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[1] This implies a conflict with the Physiocratic idea of a single net product and sterility of all but agriculture. See Kaulla, *Entwickelung der modernen Werththeorien*, p. 127.

[2] A source of confusion in the Physiocratic thought about value, and in our understanding of their thought, is their distinction between the products of agriculture and those of manufacture and trade. Much of their fragmentary discussion of exchange value concerns manufactured articles and covers only the addition in value made by working up raw materials.

Thus it does not seem possible to say that the Physiocrats regarded value as determined by cost.[1] They recognized that price must cover necessary costs, but this is far from making a "cost theory" of value. They emphasized the annual production as a factor, but this was because it limited the ability to purchase and hence the *demand* for goods.

d. *Social Classes and Scheme of Distribution; the Tableau Économique.* — The idea that extractive industries alone are "productive" led the Physiocrats to classify men into four groups: (1) the "productive" class or cultivators, who are engaged in extractive industry, chiefly agriculture; (2) the proprietors or landowners, sometimes called *disponible*, meaning independent or unoccupied, who were held to be partly productive; (3) the non-productive, called *la classe stérile.* This last group was considered to embrace merchants, artisans, and professional men. (4) Finally, and of little importance in Physiocratic thought, there are the wage workers or laborers. These four classes fall into two groups according to their "dependence": the first three are "independent" and play an active part (having some capital and exercising some enterprise); the wage earner, however, is dependent and passive.

The members of the proprietor class were looked upon as dependent upon the cultivators; and, a great part of their expenses being those of simple consumption, they were largely *stérile.* But by natural law they were charged with the administration and "reparation" of their patrimonies, and expenses incurred for the conservation and improvement of their properties were regarded as productive. The proprietor class, then, is not to be confounded with the purely sterile class.[2]

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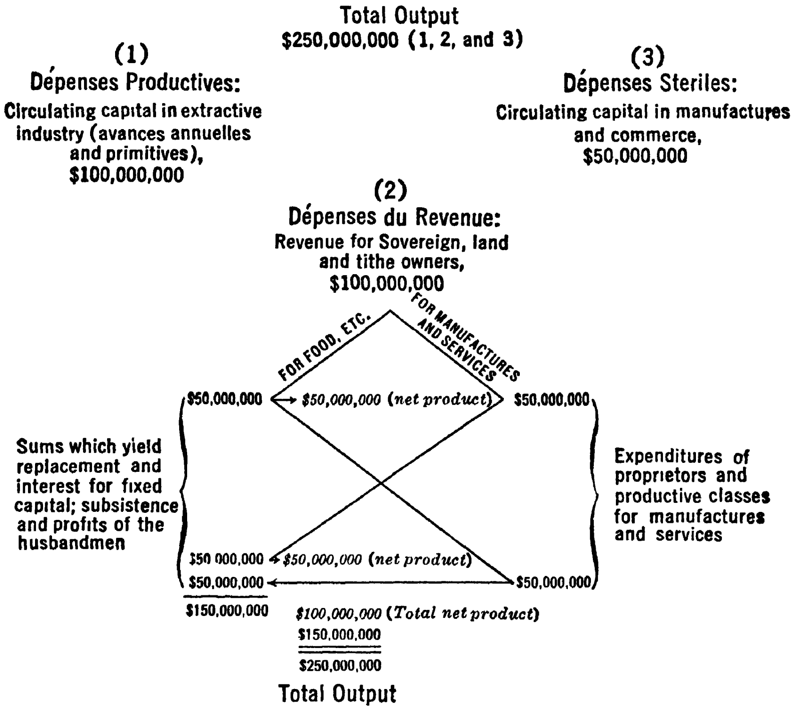
[1] Sewall, above cited, and Davenport, *Value and Distribution* (p. 107), to the contrary.

[2] *Œuvres de Quesnay* (ed. Oncken), Tableau, p. 318.

Perhaps the chief formal problem in theory to which the Physiocrats addressed themselves was the analysis of the normal circulation of the annual product of extractive industry. This was practically an elaborate analysis of the expenditures of the farming class; for, said they, the land is the ultimate source of all wealth, and the entire product must ultimately return to the hands of the productive class. It is important to remember that their object was to ascertain the natural laws whose observance would restore France to opulence.

This problem they attacked as follows. Assuming that agriculture yields returns of 100 per cent, and that productive and "non-productive" expenses are equal, they let the value of the year's harvest be put at some estimated amount, say $250,000,000. Two classes are immediately interested in this amount: the landowners and the cultivators. According to the normal distribution, $100,000,000 is at once withdrawn or retained in the immediate interest of the cultivators. This is to provide the annual expenses for circulating farm capital (*avances annuelles*), including seed, manure, repairs on machinery, wages, etc. From it, also, must ultimately be replaced to the farmer his original investment in seeds, machinery, etc. (*avances primitives*). The balance, or $150,000,000, is marketed, $50,000,000 going to the non-productive class for such things as tools and clothes, and the remaining $100,000,000 going to the landlord. With a deduction for interest on his investment in improvements like fences, drains, and buildings (*avances foncières*) this is the surplus, or *produit net.*

It is upon the circulation of this surplus (*dépenses du revenu*) that the prosperity of the nation's industry depends. It is distributed by the proprietors between cultivators or farmers of class 1 and the artisans and merchants of class 3, each class receiving $50.000,000. That is, the landlord is assumed to divide his expenses between manufactures, professional services, etc., on the one hand, and raw materials, like foodstuffs, on the other. Then the artisans and others of class 3 get their raw materials from class 1; and the farmers of class 1 get their tools and other manufactured products from class 3; with the net result that class 3 retains just enough to cover costs and replace capital, while class 1 produces a surplus for the next year.


Total Output
$250,000,000 (1, 2, and 3)
(1)
Dépenses Productives:
Circulating capital in extractive industry (avances annuelles and primitives),
$100,000,000
(3)
Dépenses Steriles:
Circulating capital in manufactures and commerce,
$50,000,000
(2)
Dépenses du Revenue:
Revenue for Sovereign, land and tithe owners,
$100,000,000
FOR FOOD, ETC.
FOR MANUFACTURES AND SERVICES
$50,000,000
$50,000,000 (net product)
$50,000,000
Sums which yield replacement and interest for fixed capital; subsistence and profits of the husbandmen
Expenditures of proprietors and productive classes for manufactures and services
$50 000,000
$50,000,000 (net product)
$50,000,000
$50,000,000
$150,000,000
$100,000,000 (Total net product)
$150,000,000
$250,000,000
Total Output

The *Tableau économique* (abridged).

One diagrammatic representation of this scheme was similar to the accompanying abridgment.

The conclusion is that the manufacturing and trading class is dependent upon the replacement of agricultural capital; and if increased luxury leads to a diversion of part of the normal flow to class 1 away from it to class 3, agricultural capital will be impaired, and the *produit net* of the next year will suffer.

e. *Wages and Interest; Population.* — As to wages, the Physiocrats, like other economic thinkers of precapitalistic days, made little contribution.[1] The laborer was supposed to get just enough to live on, and the question as to what constitutes enough to live on was not much analyzed. Turgot argued that inasmuch as the employer will pay as little as possible and has his choice among many laborers, wages are in effect limited to what is necessary for the subsistence of the laborer,[2] including possibly some small luxuries and a little saving.[3] There is no general theory of population, nor any discussion of the relation of capital to wages. The assumption of a subsistence wage was in accord with the facts in France, and it was made the "natural" wage. The question of ethical responsibility was thus removed, and labor's "share" formed no problem.

It will be observed that this idea of wages made the *produit net* a more definite and simple thing to the Physiocrats than it could have been, had a problem of wage determination existed in their minds; their surplus rested upon a subsistence basis.

Though they worked out no theory of population, one can read between the lines that they thought the *produit net* would raise up consumers for itself, and thus insure its own value, so to speak.[4]

This was thought to be advantageous. Thus Mirabeau in his *Bref état* says that the advantage of commerce is that it gives subsistence for men and the greatest number of men; improvement in machinery need not be feared, for there will always be more labor than laborers. Others saw the possibility of overpopulation, although not fearing it: "As it is in the physical order that men thus united in society multiply promptly, by a natural and necessary parallel to that multiplication they are reduced to lack the means of subsistence if they do not, at the same time, multiply those means of cultivation." [5] The multiplication of man was assumed to be a part of the natural order and was therefore regarded with optimism, a view which was possible in France at that time.

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[1] Cf. Picard, "Étude sur quelques théories du salaire au XVIII^e^ siècle," *Rev. d'hist. des doct. écon.*, 1910, pp. 153 f.

[2] *Réflexions*, 56.

[3] *Cinquième lettre sur le commerce des grains.*

[4] Cf. e.g., Turgot, *Septième lettre sur le commerce des grains* (1770) (ed. Guillamin), pp. 214 ff. Turgot comes near to a theory of population.

[5] Mercier de la Rivière, *L'ordre naturel*, p. 448.

In the matter of capital and interest, more important contributions were made. The distinction between money and capital was drawn; the origin of the latter in saving was recognized; and the necessity for constant advances, consumption, and reproduction was stated.[1] Evidences are to be found of some realization of the productivity of capital and its significance.[2] In the case of agricultural capital, one writer points out that there must be a net profit or it would be otherwise employed.[3] It was also held that interest is possible because land yields its *produit net;* and the higher the price of grain and the greater the *produit net,* the higher the interest rate.[4] Indeed, Quesnay, rejecting "supply-and-demand" and "risk" theories, argued that the rate of interest is subject to a natural law as is the revenue from land; as the income to be gained by its purchase is the law to the buyer and seller of land, the same law ought to govern the rate of interest.[5] Turgot, who was not formally a Physiocrat, suggested a productivity theory according to which interest is paid because the capitalist has the alternative of investing in land, but he did not develop the idea.

But, after all, it must again be recalled that the Physiocrats were chiefly interested in production and exchange. Hence, interest was generally regarded not so much as a share in distribution as an expense of production — as an *avance* from the revenues of agriculture. As such, competition made it just enough to cover costs; its "natural" rate was as low as possible. The founder of the school appears to have generally regarded interest as a mere replacement fund, not as a net income.[6]

f. *The Single Tax.* — In strict consistency with their doctrine that only extractive industries produce a surplus, or

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[1] E.g., Turgot, *Réflexions sur la formation et la distribution des richesses.*

[2] *Ibid.*, pp. 57–63.

[3] Mercier de la Rivière, *L'ordre naturel* (Daire's ed.), p. 459.

[4] Oncken, "Quesnay," in Conrad's *Handwörterbuch.*

[5] Quesnay, *L'interest de l'argent* (1776), Oncken's *Œuvres de Quesnay,* p. 401.

[6] *Analyse du tableau économique* (Daire's ed.), p. 62.

produit net, and in harmony with their desire to relieve not only the cultivator or farmer, but also the capitalist landowner, the Physiocrats upheld a single tax on the net income from land. This was their *impôt unique.* ✓

The assumption being made that wages and profits are reduced to a minimum by competition, while land furnishes the only return above costs, they argued, as Locke and others before them, that all taxes must fall on land ultimately. Thus it seemed better, as a matter of economy, to collect directly from those who must pay in the end. Every time a tax is transferred, said they, it increases. If the tea in a merchant's store is taxed, he not only adds the amount of the tax to the price of his tea, but also enough more to pay interest on the money advanced in taxes, and to compensate for the annoyance and trouble involved. The one who buys the tea then transfers the tax to another with an addition, and so, continually increasing, it works on, down to the owners of the soil.

More than this, however, the Physiocrats' idea of a single tax was that it would fall, not directly upon land as a property tax, but upon the *surplus* which land may yield. Before this surplus could arise, costs, including capital charges, would have to be provided for. Presumably, therefore, an owner-cultivator would have been benefited by such a tax as compared with the multitude of tax burdens of the day.[1]

Though the single-tax idea was based upon an erroneous notion of productivity, and violated important principles of fiscal expediency, it rendered a great service.[2] Under the advocacy of it, the cumbersome, wasteful mass of taxes which prevailed was criticized; and the discussions to which it gave rise led to a better understanding of the principles of taxation.

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[1] "This tax will be paid without reducing at all the net revenue which the new proprietor has counted on in buying the land," wrote Mercier in *L'ordre naturel.*

[2] The modern single-tax idea of Henry George and agrarian socialists is, of course, quite different from the Physiocratic plan. The latter recognized the rights of the landowner and would have guaranteed property in land. Nor did they aim to seize an "unearned" income.

The Chief Physiocrats and Their Writings. — Though they were mostly differences of emphasis, rather than anything more fundamental,[1] some differences of opinion existed among the Physiocrats. For example, the theory of interest and the degree of government interference were debated points. A few words are therefore required for the purpose of individualizing the more important members of the school.

It may be conducive to a clearer understanding of the relations of the several Physiocrats to one another, to distinguish Physiocracy in the broad sense from the Physiocrats in the narrower sense. In the broad sense, Physiocracy was the philosophy of the revolt against Colbertism, and of the movement for *laisser faire.* In this sense, it embraced a number of men who differed considerably in their economic views: Gournay, Quesnay, Turgot, and perhaps even Condorcet and Condillac. In the narrower sense, however, considered as a group of economic theorists (concerned with the *produit net* and the *ordre naturel*), Quesnay was the master, and the disciples were Mercier de la Rivière, Mirabeau, Le Trosne, Dupont de Nemours, and Baudeau. Gournay maintained entangling alliances with those Mercantilistically inclined (Morrelet, Butel-Dumont, and Forbonnais), and he did not accept the *produit net* idea. Turgot, while more in accord with Quesnay's economic theories, did not follow him in political absolutism, and was more historical in his point of view.

If the foregoing distinction be disregarded, and the Physiocrats be considered as a single group, it may be said that the chief representatives of the school were François Quesnay (1694–1774), and Anne Robert Jacques Turgot (1727–1781). There are others, like Jean Vincent de Gournay (1712–1759), Mirabeau, Mercier de la Rivière, Dupont de Nemours, Baudeau, and Le Trosne, who are important; but the two first named are the more original. Few, if any, ideas of fundamental importance for economic theory were added by the others.

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[1] These differences are emphasized by Oncken in his introduction to the *Œuvres de Quesnay.*

It may be truly said that from the point of view of economic theory, Quesnay is the chief figure. He was the unquestioned leader of those "Économistes" who formed the school or sect. His chief writings were the following: an article on "Fermiers" (1756), one on "Grains" (1757) — both published in Diderot and D'Alembert's *Encyclopédie;* the *Tableau économique* [1] (1753-1758); "Maximes générales du gouvernement économique d'un royaume agricole," published in Mirabeau's *Philosophie rurale* (1763); and his *Droit naturel* (1768). In the first two articles the basis for his system will be found. His ideas as to the distribution of wealth are stated and illustrated by tables in the famous *Tableau économique.* Quesnay led in his emphasis of agriculture, demanding that it be brought to the highest perfection. The maxim "poor peasant, poor kingdom; poor kingdom, poor king" is generally attributed to him. He favored a greater degree of freedom of trade and industry in order to give agriculture the greatest chance to expand.

Gournay, who cannot be said to have been a member of the strict school of Quesnay, was not, like Quesnay, the son of a farm-owner. He spent fifteen years engaged in trade at Cadiz, then traveled in England, Holland, and Germany, and finally settled down in 1751 as an intendant of commerce. He translated certain works of Sir Josiah Child and of Culpeper; but wrote little himself. His chief work was administrative and advisory to others. He lived in Turgot, whose *Éloge* upon the death of Gournay is an important source for the latter's ideas. These were, in brief, that government should be confined to restoring liberty to all branches of commerce and to encouraging competition, thus protecting production and lowering prices. He believed that manufacture and trade are productive. He stimulated interest in economic analysis and reforms by gathering a "school" around him. To Gournay is commonly attributed the famous saying *laissez faire, laissez passer*, and, whether or not he originated the whole maxim, he seems to have made it his own.[1]

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[1] See above, p. 189. This work was reproduced in facsimile for the British Economic Association, London, 1894. It is to be found in Gray, A., *Development of Economic Doctrine*, p. 106.

Turgot, while keeping himself formally distinct from the sect of the Physiocrats, was in essential agreement with their main doctrines. As an advocate of *laisser faire* and the idea that the individual knows his own interest best, he was outstanding. He claimed Gournay for his master, and, while emphasizing their non-productivity, he leaned toward a greater recognition of the service of the non-"productive" classes. But he differed from both Quesnay and Gournay at some points.[2] He had a better understanding of the relation of saving to capital formation; he defended freedom to lend and borrow at interest; and he was opposed to the system of political autocracy which Quesnay favored.

It was Turgot's fortune — first as intendant, then as finance minister to Louis XVI — to put in practice some Physiocratic principles. His best-known writings are: *Réflexions sur la formation et distribution des richesses* (1766, published 1769); a memorial *Sur les prêts d'argent* (1769); letters on *La liberté du commerce des grains* (1770). His letter to the Abbé Cicé (1749) on the subject of paper money and coin was an early blow at Law's system, and shows a good understanding of the relation of money to price.

Turgot's *Réflexions* consists of a hundred paragraphs, the first seven of which attempt to prove that agriculture alone increases the wealth of the nation and that manufactures and trade depend upon it. In the last few paragraphs he concludes that land revenues are the only proper source for taxes. The remainder largely deals with money and capital.

There has been some difference of opinion as to the historical significance of these *Réflexions*. Cossa declares that the book deserves to be entered in red-letter, as the first scientific treatise on social economics.[3] On the other hand, Jevons and Higgs[4] would rather emphasize Cantillon's work in this connection. There can be little doubt as to the superiority of Turgot's work. But when we reflect that he had the shoulders of Cantillon, Hume, Gournay, and Quesnay to stand on, there may be some doubt as to which did the greater work, relatively. It may simply be suggested that, while Cantillon wrote a scientific essay, Turgot wrote a bigger and better one, just as, ten years later, Adam Smith surpassed Turgot. All three are now read as milestones in the history of economic thought. The question is to be decided in the light of obstacles overcome or of the amount of new truth given.

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[1] See Schelle, *L'économie politique et les économistes*, pp. 166 ff.

[2] See Oncken, *Gesch. d. National Ökonomie*, pp. 459 ff.

[3] *Introduction to Political Economy*, p. 264.

[4] *The Physiocrats*, p. 94.

For the best concise statements of the Physiocratic doctrine one must turn to *L'ordre naturel et essentiel des sociétés politiques* (Paris, 1767) by Mercier de la Rivière; Abbé N. Baudeau's *Première introduction à la philosophie économique* (Paris, 1771); and Le Trosne's *De l'ordre social* (1777). The work of Mirabeau's called *Philosophie rurale ou économie générale et politique de l'agriculture* (1763) is also to be mentioned in this connection. Dupont de Nemours also wrote a brief but comprehensive work, *Physiocratie ou constitution naturelle du gouvernement le plus avantageux au genre humain* (1767). It was from this title that the school received its name.

Philosophy. — Under the general outlines of Physiocratic Political Economy, the chief points in the philosophy underlying Physiocracy have been touched upon. Emphasis of the material, individualism, self-interest, natural order, and optimism. The difficulty of harmonizing the elements in this list is apparent at a glance. How can one be a thoroughgoing materialist and at the same time be an optimist? How can a reliance upon self-interest go hand in hand with a belief in a divinely appointed natural order?

In order to understand this curious situation, it is necessary to know something of the philosophies which prevailed in France during the eighteenth century. It is to be remembered that economists were not specialists in those days, but covered broad fields in their speculations. Such names as Grotius, Pufendorf, Hobbes, Locke, Hume, and Montesquieu have appeared in the list of those who contributed to economic thought, and the Physiocrats were themselves closely allied with a school of philosophers known as the Encyclopedists. The connection between philosophy and economics was much more direct, and was given much more recognition than is now the case. Economics was just being developed, and was a branch of "moral philosophy."

John Locke (1632–1704) was the father of the philosophy of the Physiocrats, their rationalism and emphasis of nature tracing largely to him. Hardly second to Locke, however, was the influence of the French philosopher René Descartes (1596–1650). Now both these thinkers were dualists, i.e., they did not synthesize mind (ideas) and matter. They were both unfinal. Locke tended toward materialism in making knowledge chiefly dependent upon sensations received by a passive mind from its environment; but he also admitted "reflection" by which the mind as an active force gains knowledge of ideas. Descartes sought to found knowledge on the basis of self-consciousness considering innate ideas as eternal verities; but he also taught that extension is an ultimate reality. In the light of innate ideas, the mind interprets data which are furnished to it by the senses. Thus Descartes, although a dualist, tended toward idealism. He believed that God created the world and that a divinely appointed order exists which is not arbitrary, but natural.

While in part adopting the idea of a divinely appointed natural order, however, the Physiocrats tended toward the materialism which predominated in Locke's thought. One factor in the situation was the thought of the philosopher, Helvetius (1715–1771), who was closely associated with the Physiocrats, and who was a materialist of the Hobbes-Locke-Hume type. All ideas, he believed, are impressions from without; and consequently differences among men are circumstantial, depending upon education. Self-interest actuates men, and pleasure and pain are the motivating forces. Condillac also had similar ideas.

On the other hand, the influence of the French philosopher Malebranche (1638–1715) served to keep alive an idealistic element in Physiocratic thought, offsetting, as it were, the influence of Helvetius. Malebranche was a priest who became a disciple of Descartes and later sought to explain the world of mind or spirit, and to bridge the gap between mind and matter, which his master had left. He found the cause of all phenomena in God and made both matter and mind exist in God. Thoughts and bodily acts may occasion one another, but the cause of all lies in the divine mind.

And Spinoza (1632–1677), by carrying Descartes' philosophy into pantheism, helped to develop a basis for an idealistic concept of natural law; for, after saying that the life of each is inextricably bound up with the lives of others, he adds that "pure intelligence corrects this fragmentary view, and forces us to connect things, and to regard the universe not as an aggregate of isolated facts, but as a unity."

It will now be clear why so many fundamental inconsistencies are to be found in Physiocratic thought; they were the children of an unfinal, dualistic philosophy. At the same time that they were in many respects rationalists, engaged in tearing down outworn dogmas and putting things to the test of reason, they were also making a metaphysical idea of "natural" order, instituted by Divinity, the corner stone of their system. At the same time that they were arguing for the free play of self-interest, they were upholding the need of strong, centralized government which would overcome the difficulties arising from natural inequalities among men and differences in desirability of occupations. The dual series of inharmonious ideas may be indicated as follows:

MATERIALISM	IDEALISM
"The institution of society is the result of physical necessity," etc.	By contemplating "that which is naturally in us" we are convinced that "the union of men in society is in the general plan of creation."

RATIONALISM Reason proves that only by the laws of the physical order are physical causes bound to their results. The natural order makes itself known by the aid of the sole light of reason.	RELIGIOUS TELEOLOGY "Natural order"; "divine purpose." Multiplication of human species is manifestly the intention of the Creator.
HEDONISM "To obtain the maximum augmentation of enjoyment by the maximum diminution of expense, is the perfection of economic conduct."	AFFECTIONS IMPORTANT Man is susceptible to compassion, pity, amity, benevolence, glory, emulation, etc., and is, therefore, clearly destined to live in society.
INDIVIDUALISM Self-interest will lead to coöperation.	MONARCHICAL GOVERNMENT Government is needed to maintain property rights and carry out the order of nature.
LAISSEZ FAIRE	PROTECTION TO AGRICULTURE
WEALTH ALL-IMPORTANT Market value is the only rule by which to judge the advantage which the state derives from any given kind of production.	WELL-BEING NOT WEALTH Well-being lies in *abundance* of enjoyable objects.

The Physiocrats, however, were too wise as philosophers to let all conflicting ideas pass without some synthesis. In the field of metaphysics, some of them would class with Malebranche, in that they found in God the bridge between ideas and matter, and their thought was accordingly deeply tinged with idealism. The *ordre physique* and the *ordre naturel* were regarded by these as interrelated, in that the two were instituted by the Creator. The key, however, to the synthesis which more or less consciously was adopted by the leading Physiocrats — those in whom materialistic tendencies predominated — is undoubtedly to be found in the place which they assigned to *reason.*

On the one hand, reason can modify the material environment to suit ideas, and on the other it can adjust ideas (instincts and emotions) to meet environmental conditions, in this way bringing mind (ideas) and matter together. The *ordre naturel* was supposed to have its authority solely in its obviousness to the human reason and in "the irresistible force with which it dominates and subjects our wills." Self-interest was reconciled with government by the assumption that self-interest would be intelligent. All individuals were assumed to be dependent for their welfare upon the quantity of the *produit net*, and therefore each would seek so to act that the *produit net* would be increased. Mercier expresses the general idea thus: "That which is called the state is a political body composed of different parts united by a common interest, which does not permit them to detach themselves from it without their suffering injury." (*L'ordre naturel*, p. 369.) In short, the Physiocrats in the last analysis relied upon an intelligent appreciation by each individual of his relations with and dependence upon his fellows, for the practicability of their theories. This reliance was generally a mere tacit assumption; but it was there.

The foregoing statement brings out clearly the highly abstract character of the Physiocratic system of economic thought. As a system it did not fit the fact that unreflective impulse, ignorance, and selfishness are widespread, and therefore it could not succeed as the basis for a practical economy.

With further reference to the need of a synthesis, it should be noted that Quesnay, at least, recognized that both abundance of goods and value are required in order to make a nation really wealthy. It is also fair to say that as between individualism and autocracy, their synthesis is to be found in the idea that the king should do little, and that government should make laws conforming to the *ordre naturel.*

English Followers.[1] — Contrary to the common opinion, the Physiocrats were not without some following in English thought, though it was a weak one. In America Benjamin Franklin was acquainted with the Physiocrats and had some notions concerning productivity similar to theirs. And in England, in 1797, "some false doctrines of Dr. Adam Smith and others" were attacked on Physiocratic grounds by an anonymous writer. Prosperity was made by this writer to depend upon high rents, the "net product" of the Économistes. Another anonymous work, *Sketches on Political Economy . . . with an Exposition of Some of the Leading Tenets of the Economists* (1809), argued that capital cannot reproduce with an increase, — that, being itself a result, it cannot cause that from which it results. This, land alone could do.

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[1] See Seligman, "Some Neglected British Economists," *Econ. Jr.*, XIII, 336 ff. (1903); Higgs, *The Physiocrats*, p. 137. For the influence of Physiocratic thought in other countries see Cossa, *Introduction to Political Economy*, p. 272.

The little book by Brydges on *Population and Riches* (1819) also reminds one of the Physiocrats, as he states that the basis of all riches is the produce of nature, that a man's labor in agriculture can produce a surplus above his subsistence, which surplus is distributed, first among manufacturers, secondly among non-producers. He carries the ideas of Smith and the Physiocrats on non-productive classes to the extreme. The animus of the work appears to be a defense of the landed interests in England.[1]

William Spence may also be mentioned here as one who upheld Physiocratic theories.[2] The Industrial Revolution, however, had made such views as to the relative position of land and capital pretty clearly untenable in England.

Critics. — Among the chief critics of the Physiocrats' economics, Galiani and Condillac may be especially mentioned.[3] The Italian, Galiani, published a book on money in 1750,[3] and his better-known *Dialogues sur le commerce des blés* in 1770. He was an opportunist, opposing the idea of the natural order and attempts to construct systems of economics. In his work on *Le commerce et le gouvernement* (1776), Condillac, while agreeing with the Physiocrats in some respects, refuted the idea that manufactures are sterile, and contributed to the theory of value.[4] Graslin, Linguet, Mably, Rousseau, and Voltaire (*L'homme aux*

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[1] It is interesting to note that he drew largely upon Sismondi.

[2] See, e.g., his *Tracts on Political Economy*, 1822.

[3] Portions of this, and a brief sketch of Galiani's work, appear in Monroe (ed.), *Early Economic Thought*, pp. 280 ff.

[4] See below, p. 587.

quarante écus), also attacked the class interest which they found in the Physiocratic landowners' theory of the *produit net.*[1]

The Practical Influence of Physiocracy. — The system of the Physiocrats found admirers among sovereigns of various states. Those who are known to have been believers in it to a greater or less extent are Catherine II of Russia, Joseph II of Austria, his brother Leopold, Archduke of Tuscany, and Carl Friedrich, Margrave of Baden. Joseph II and Leopold do not appear to have been very earnest followers of the Physiocrats. They made some attempts, however, to carry out their principles, except in so far as they related to free trade. Carl Friedrich, the Margrave of Baden, was, on the contrary, a whole-souled believer in the Physiocratic system. He even wrote a work advocating it, entitled *Abrégé des principes d'économie politique* (A Compendium of the Principles of Political Economy), published in 1775. He made an attempt to introduce the system practically in three villages in Baden, namely Dietlingen, Theningen, and Balingen. It was impossible to carry out the attempt. It must necessarily have failed, even supposing the teachings of the Physiocrats to have been correct. An instantaneous change from one system of public economy to another and quite different one can hardly be accomplished without serious harm. Again, the matter was made worse by endeavoring to maintain both systems side by side in the same land. Besides all this, the plan was badly executed. The experiment was given up in two of the villages, Theningen and Balingen, in 1776; in Dietlingen it was continued until 1792.[2]

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[1] Weulersse, above cited, pp. 147, 439, 513, 629. The American, Hamilton (see below, pp. 316 f.), the Italians, Beccaria and Verri; the Germans, Möser, Büsch, and Justi; and the French writers, Forbonnais, Necker, and Herrenschwand, may also be classed as critics. Herrenschwand was a Swiss physician who may be regarded as a predecessor of Malthus. He wrote a *Discours fondamental sur la population* (1786). For others see Roscher's *Geschichte der Nat.-Oek. in Deutschland.*

[2] Further information about this experiment will be found in Roscher's *Geschichte der Nat.-Oek. in Deutschland*, § 110; and in an essay by A. Emminghaus, published in the *Jahrbücher für national Ökonomie und Statistik*, Vol. XIX (1872). The title is "The Physiocratic Experiments and Connections of Carl Friedrich of Baden." Also Knies, *Carl Friedrichs von Baden brieflicher Verkehr mit Mirabeau und Du Pont.*

CHAPTER X

ADAM SMITH, HIS IMMEDIATE PREDECESSORS, AND THE REVOLUTION IN INDUSTRY

The Scotchman, Adam Smith, born in the year 1723 at the village of Kirkcaldy, published in 1776 the book commonly known as the *Wealth of Nations.*[1] By this book he won a fame greater than that of any other writer on political economy or allied subjects. Abundantly criticized, and with its originality not unassailed, his work still stands as truly epoch-making in the evolution of economic thought, while its maker is called the Father of Political Economy.

Immediate Predecessors of Adam Smith. — Though so truly epoch-making, Adam Smith, as is generally the case, built upon the work of his predecessors. Nor can one overlook the forerunners in a study of the master's achievement. Adam Smith was acquainted with the writings of the Mercantilists, the philosophers of the seventeenth and eighteenth centuries, and the Physiocrats; and he stood upon their shoulders. The names of Petty, North, Child, and Steuart, and those of Locke, Berkeley, Mandeville, Hutcheson, Hume, Tucker, and Ferguson, must ever be remembered in this connection. Smith also refers to Cantillon; and a work by Harris, a follower of Cantillon, was known to him. Dating from the eighteenth century, too, there are many books and pamphlets, often anonymous, which relate to economic subjects; but inasmuch as there is no evidence that they exerted any influence on the course of economic thought, it does not seem expedient to discuss them here. While remembering Smith's great debt to the Physiocrats, — and theirs to the Scotch and English writers, — the continuity in England's economic thought should be emphasized; and Hutcheson, Hume, Tucker, and Ferguson may be named as the chief of his immediate predecessors. These men come near to forming one school with Smith as their master.

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[1] On Adam Smith, his life and work, see: Cannan (ed.), Smith's *Lectures on Justice, Police, Revenue, and Arms*, 1896; Feilbogen, *Smith und Turgot;* Hasbach, *Die allgemeinen philosophischen Grundlagen der von F. Quesnay und Adam Smith begründeten politischen Oekonomie*, 1890, and Hasbach, *Untersuchen über Adam Smith*, 1891; Oncken, *Adam Smith und Im. Kant;* Rae, *Life of Adam Smith;* Small, *Adam Smith and Sociology*, 1907; Zeyss, *Adam Smith und der Eigenutz;* Ginzberg, E., *The House of Adam Smith*, 1935. The chapters or essays on Smith in Cannan's *Theories of Production and Distribution*, Leslie's *Essays in Moral and Political Philosophy*, Bagehot's *Biographical Studies*, and Bonar's *Philosophy and Political Economy* are valuable.

While, as we have seen, the Physiocrats had a doctrine of self-interest, it is highly probable that Smith's emphasis of self-interest and the related tendencies in his thought were stimulated, if not originated, by the spirit of Mandeville's celebrated *Fable of the Bees.* Though he at first expressed himself enigmatically, it appears to have been Mandeville's idea that upon the multiplicity of wants "depended all those mutual services which the individual members of a society pay to each other: and that consequently, the greater variety there was of wants, the larger number of individuals might find their private interest in laboring for the good of others, and united together, compose one body."[1] Mandeville, too, clearly expressed the idea of division of labor, using the production of watches and clocks as an illustration, and he was perhaps the first to use the words "divided" and "division" in this connection.[2]

But Francis Hutcheson exerted a deeper and more comprehensive influence upon Smith. Hutcheson was one of Smith's teachers at Glasgow (1737–1740) and Smith actually expressed indebtedness to him. His *System of Moral Philosophy* shows that, while he had some Mercantilistic ideas concerning balance of trade, government regulation, and population, he foreshadowed his pupil's work at several points. For one thing, he handed down to Smith many views of Pufendorf, Grotius, and Locke — some deriving from the Stoics; gave him, or at least strengthened, his optimistic nature philosophy; and it has even been argued that the arrangement of the *Wealth of Nations* was affected by Hutcheson's lectures.[1] Hutcheson assumes instincts, or "senses," of benevolence and self-interest, but considers the "moral sense" to be most important. His thought was utilitarian in trend, and he proposed the greatest happiness of the greatest number as a standard. Furthermore Smith may well have got from him certain purely economic ideas, notably on division of labor, value, money, and taxation. Thus Hutcheson distinguished utility and value, saying that "the natural ground of all value or price is some sort of use," that wealth is differentiated from utility by labor, and that limitation of supply makes a scarcity value.[2] He also makes allowance for the rarity or scarcity of materials in nature. Hutcheson justified interest on the ground that money might be invested in things "naturally productive."

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[1] Edition of 1724, p. 465. First edition about 1705; second, enlarged, in 1714.

[2] Edition of 1729, part ii, p. 335. See Cannan's introduction to his edition of Adam Smith and note on page 5 of Vol. I.

Doubtless Hume[3] exercised the greatest influence on the general philosophy of Smith, as well as on his economic opinions. During his stay at Glasgow, Smith made an abstract of Hume's *Treatise of Human Nature* which pleased the older man and was the beginning of a lasting friendship. Hume was an essayist, writing in a philosophical spirit, but working out no complete economic system. If he had written a systematic treatise in 1752, when his essays appeared, the *Wealth of Nations* in all probability would not have occupied the unique position it now holds. The chief characteristics of Hume's economic thought are the prominence given to labor, the attention given to changes or transitions, evidences of historical spirit, and the interrelation of economic and other social facts and forces. Though he, like Hutcheson, shows traces of Mercantilism he had a good understanding of foreign trade. "Not only as a man but as a British subject I pray for the flourishing commerce of Germany, Spain, Italy and even France itself." Everything that is useful to man springs from the ground; but artisans are necessary to work up most things and in "the stock of labor . . . consists all real power and riches." [1] Hume holds that everything in the world is purchased by labor, and that our passions are the only cause of labor.[2] Money is nothing but the representative of labor and commodities, and for any one country its greater or less abundance is immaterial; but the increase in the supply of money may benefit industry during the interval between acquisition and resulting rise in prices. Interest depends upon the profits of industry and the demand for and supply of loans.[3]

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[1] See W. R. Scott's *Francis Hutcheson.*

[2] *System*, Vol. II, pp. 53 ff.

[3] Klemme, *Wirtschaftliche Anschauungen David Humes.*

Josiah Tucker (1712–1799) [4] was dean of Gloucester. Between 1750 and 1776 he wrote several essays on commerce and taxation,[5] and one of his writings was translated by Turgot.[6] He too laid emphasis on the significance of labor. He believed in the advantages of a large population and favored a tax on celibacy, and has been called the true forerunner of the "Manchester School." [7] Tucker's free trade policy was based on the idea of a harmony of interests. Self-interest was made by him the chief motive, and this, he thought, if given free play, would coincide with public interest in most cases.

It may be said that Hume and Tucker inaugurated cosmopolitanism in commercial policy.

Adam Ferguson (1723–1818) did not separate economics from politics, but in his lectures and writings,[8] dealt with economic topics, and, as a contemporary and friend of Smith's, he must have had some influence. His maxims of taxation, though not the same, may have influenced Smith's famous canons. His treatment was ethical. He had some idea of the principle of relativity.

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[1] *Of Money.*

[2] *Of Commerce.*

[3] *Of Interest.*

[4] See W. E. Clark, *Josiah Tucker*, Columbia University Studies, Vol. XIX, No. 1.

[5] *Brief Essay on the Advantages and Disadvantages which respectively attend France and England with regard to Trade* (1748); *Elements of Commerce* (1752); and others.

[6] *The Expediency of a Law for the Naturalization of Foreign Protestants*, translated as *Questions importantes sur le commerce*, 1755.

[7] For Manchester School, see below, p. 237.

[8] *Essay on the History of Civil Society* (1767); *Institutes of Moral Philosophy* (1769).

On the point of the theory of value and utility, Harris in his work *On Coins* (1757) was influential in shaping Smith's thought; for he wrote: "Things in general are valued not according to their real uses in supplying the necessities of men; but rather in proportion to the land, labor, and skill that are requisite to produce them"; and he contrasted water and diamonds to illustrate the point (p. 5).

These men, then, broke the way in England for the development of political economy as a science. Their position in the development of English economics may be likened to that of Boisguillebert and Cantillon in the development of Physiocracy. More or less markedly they taught that labor is the source of wealth, and advocated industrial or "natural" liberty.

Smith's Life and Relations with the Physiocrats.[1] — At the age of fourteen Smith went to Glasgow, where, as already indicated, the philosopher Hutcheson profoundly affected him. Hutcheson was lecturing systematically on economic subjects under the branch of his philosophy which he called "Natural Jurisprudence." Smith then went to Oxford on a scholarship, where he studied the classics. Between 1748 and 1751 he lectured on rhetoric and belles-lettres at Edinburgh; after which he became professor at Glasgow, — first of logic, then of moral philosophy. "In the last of these lectures he examined those political regulations which are founded, not upon the principle of *justice*, but that of *expediency*, and which are calculated to increase the riches, the power, and the property of a state. Under this view he considered the political institutions relating to commerce, to finances, to ecclesiastical and military establishments."[2] We know that in 1754 while at Glasgow he discussed the effects of a bounty on the export of corn, talking much with merchants and convincing many of the advantage of free trade.

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[1] Rae, *Life of Adam Smith.*

[2] Words of Millar, a student of Smith's, in Stewart's *Works*, Vol. X, p. 12.

In 1759 his *Theory of Moral Sentiments* appeared. Five years later we find Smith traveling in Switzerland and France, and while there he began work on a book which in twelve years was to develop into his masterpiece, the *Wealth of Nations.* He met Diderot, D'Alembert, Quesnay, Turgot, and others. Conversing often with Turgot on economic topics, it is natural that both men were influenced. Turgot was engaged on his *Réflexions* and Smith on his *Wealth of Nations.* Say's opinion that Turgot owes much of his philosophy, Smith much of his economics, to this intercourse, seems reasonable.[1] It seems more reasonable, however, to minimize the contributions made by these men to each other's development, and to consider them both as affected by common environmental forces.

✓"The three same fundamental conceptions," says Cliffe Leslie,[2] "derived from the three same sources — from Græco-Roman speculation, from Christian theology, and from the revolt of the age against arbitrary interference with private industry and unequal imposts on the fruits of labor — formed the groundwork of the political economy of Adam Smith and the Physiocrats." These "fundamental conceptions" were, respectively, (1) that of natural rights, (2) that of a beneficent Providence, and lastly (3) the idea of *laisser faire* derived from the doctrine of self-interest and the reaction against government interference. None of them can be said to be the invention or the property of any man or school. In any case, all of them can be found in the writings of Hutcheson, Hume, and Tucker.

From among these fundamentals of Leslie's, a fourth might be distinguished, namely, the principle of self-interest as the fundamental force in society. In this connection the appearance of Helvetius' work *De l'esprit* (1758) deserves comment.[3] His teaching that self-love is life and power; unselfish benevolence, nothing, produced a wonderful sensation in France and elsewhere. It may have been instrumental in causing Smith to shift from sympathy to self-interest as the chief motive in life.[1] His predecessors in England, however, and especially Mandeville, may be regarded as probably having the most immediate influence here.

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[1] Leon Say, *Turgot*, p. 33.

[2] "The Political Economy of Adam Smith," *Fortnightly Review*, 1870. Republished in his *Essays*.

[3] Cf. Kuno Fischer, *Francis Bacon u. seine Nachfolger*, p. 687 and above p. 197.

To this analysis, there should be added the idea of cosmopolitanism, which, indeed, is implicit in the idea of the law of nature — and probably in the doctrine of individual self-interest. In the eighteenth century, men came to generalize. Smith's cosmopolitanism was typical of a time when it was written that all men are born free and equal.

The Wealth of Nations. — With the continental ferment of a sensualistic nature philosophy working upon the similar ideas of his own and his predecessors, Adam Smith returned to England in 1766, and after nine years of rather secluded retirement at Kirkcaldy, Scotland, published his book, the *Wealth of Nations*, in 1776.

Never was time riper for a comprehensive work on economics! Everywhere the old order was shaken; everywhere new ground had been broken; but nowhere had the crop appeared. Tracts and essays had been published in England, and *tableaux* and tomes in France; but all lacked either system or comprehensiveness, or were marred by Mercantilistic taints or reactionary errors. Revolutions in industry, in philosophy, in politics, were in the air: in the same year that the *Wealth of Nations* appeared. Watt invented his steam engine and the Declaration of Independence was signed in America. What wonder that men hailed with extravagant praise an analysis and explanation of the new order!

The wealth of nations had by Smith's time become a vastly different matter from that of the Medieval or Mercantilist periods. Peace reigned throughout his life! Commerce was greatly extended. And along with these, there was a remarkable development of individual initiative which marked a vital change in social and economic life. The individual found increasing self-expression in the arts, in science, in politics, and in business. In England, for example, local government, and the formation of business "companies," indicated the growth of voluntary coöperation among individuals. In general, there came greater chances for individuals to rise in the social scale. And along with the system of "enclosures," large agricultural estates had come to be run for profits, while mechanical inventions and the increased use of machinery were leading to the factory system of manufacture. During Smith's life, however, the "domestic system" of manufacture continued to prevail, with its relatively small capitalist employers and wage earners working in their homes or small shops. Smith did not witness the final emergence of the factory system — that remained for Ricardo and Malthus.

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[1] **Knies**, *Die politische Okonomic vom Standpunkt der geschichtlichen Methode*, p. 150.

In these respects, Smith's material environment was not only different from that of his Mercantilist predecessors, but was much more developed than that of the Physiocrats. It challenged the observing philosopher to a new explanation.

Economics was born of a philosophy, particularly "moral philosophy," that had come to center upon the increasingly complex and acute problem of human relations. Many thinkers had broken away from the religious dogma of Medievalism, and from the mere political policy of Mercantilism. They had developed the idea of "law" governing society — law deriving from the nature of man himself, whether based upon a "moral sense," or self-interest, or a combination of the two. But even so, the more practical problem of the *means* of life, as distinguished from the goal or ends of existence, remained. More or less unconsciously, the Physiocrats and Adam Smith sought to develop a quantitative appraisal of the means of livelihood — of "wealth" as distinguished from "welfare." This is the significance of economic value, and "the price system."

The age-old question as to whether the nature of man himself is "spiritual" and largely independent of material environment (idealism), or is material and largely controlled by physical conditions (materialism) was not answered. But the founders of scientific economics, on the whole, leaned strongly toward materialism, and this made it easier to formulate a system which, in their environment, was useful as a working explanation of economic life. It made it easier to see social uniformities, and to think of man as subject to the reign of law.

An Inquiry into the Nature and Causes of the Wealth of Nations was the full title of the book; and this title was considered by Smith to be an adequate definition of the scope of political economy.[1] So far as the book has a plan it appears to be as follows: beginning with the importance of labor as the source of the annual wealth of a nation, Smith discusses division of labor as the means for increasing the productiveness of labor and hence the nation's wealth. Division of labor necessitates exchange, and this is the next topic. This leads up to money as the medium of exchange, and to value. The discussion of price follows, and then the components of price: wages, profits, and rent — according to Smith. Finally the criticism of Mercantilism and Physiocracy follows; and the last book deals with public finance.

In his conception of the "annual wealth" and "annual labor" of a nation Smith was undoubtedly influenced by the Physiocrats.

The Importance of Labor and Division of Labor. — The Physiocrats had made land or the bounty of nature the center of their system. In the sense in which they used the word, land alone was "productive." Certain ones among the Mercantilists,[2] however, spoke of labor as the active principle or father of wealth, though attaching most importance to mercantile and maritime pursuits. Adam Smith makes much of labor. The first words in his book are, "The annual labor of every nation is the fund which originally supplies it with all the necessaries and conveniencies of life"; and, as will be seen later, he makes labor both cause and measure of value.

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[1] See Introduction to Bk. IV (Cannan's ed., p. 395).

[2] Above, p. 136.

It must not be inferred that Smith means all human exertion which adds utility; he limits his emphasis of labor to "productive labor." This reminds one of Physiocratic distinctions. But there is this difference: the Physiocrats made productivity equal the creation of a surplus over costs;[1] by Smith, productivity was extended to include any addition to exchange value, the produce of labor being "the value which it adds to the materials upon which it is bestowed."[2] But exchange value he confined to *vendible* commodities. Thus Smith regarded menial servants, public officials, and professional men as unproductive; their work perished on the instant of production.[3] This is very like Child's opinion.[4]

Smith's treatment of the advantages of division of labor has long been deemed a classic. He did not originate the idea, for traces of it have been found from the Greeks on; but he so enriched it that ever since the appearance of the *Wealth of Nations* it has had a new importance in economics. Smith makes an innate "propensity to truck and barter" the cause of division of labor among men. This is hardly rational enough for the present day; but a more satisfactory explanation is suggested in its "advantage" coming from an "increase of the productive powers of labor," special adaptations among men giving rise to this advantage. The occasion for such a division is, of course, the power of exchange. Division of labor, he points out, is limited by the extent of the market.

As to its advantages, Smith says: "The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is anywhere directed, or applied, seem to have been the effects of the division of labour."[5] Pin making, for example, is a peculiar trade which is "divided into a number of branches of which the greater part are likewise peculiar trades." As a result, each man produces at least 240 times as many pins as if he worked alone. The advantages are analyzed as being due to three circumstances: the increase of dexterity in the individual workman; the saving of time otherwise lost in passing from one process to another; and "to the invention of a great number of machines which facilitate and abridge labour."

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[1] And the Physiocrats did not logically impute "productivity" to labor, but to land.

[2] *Wealth of Nations*, Bk. I, Chap. VIII (Cannan's ed., p. 67)

[3] *Ibid.*, Bk. II, Chap. III (Cannan's ed., p. 313).

[4] Above, p. 136.

[5] Bk. I, Chap. I (Cannan's ed., p. 5).

It is important to note that this statement of the case for division of labor was a real contribution, for earlier statements had attributed the phenomenon chiefly to differences in natural aptitudes of man, and to special environmental advantages.

Value. — Smith begins his discussion of value by distinguishing value in use from value in exchange: the former is similar to the utility[1] of recent economic analysis, such as is possessed by water and air; the latter is the power of purchasing goods, of which diamonds afford an illustration. "The things which have the greatest value in use have frequently little or no value in exchange; and, on the contrary, those which have the greatest value in exchange have frequently little or no value in use." In this distinction Smith is in accord with the idea of *valeur usuelle* and *valeur vénale* as held by Quesnay and the Physiocrats. It will be noted that this treatment limits "use" in a sense not now observed by economists, involving as it does an ethical idea, or at least a distinction between different grades of wants. John Stuart Mill later called Smith to account for denying utility to anything which satisfies human wants, as diamonds undoubtedly do. Smith and his followers have also been criticized with some justice for failing to distinguish the concept of utility from "value in use."[2] Doubtless the coupling of "value" with "use" in a single term tended to conceal the significance of bare utility and to prevent the separation of the objective value in use from the subjective.

Smith, however, is concerned with exchange value alone, which he defines as the "power of purchasing other goods" which a commodity possesses. His conception of value, then, is entirely objective. He considers value in use and value in exchange as practically independent and almost as unrelated. "The real price of everything," he says, "what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it."[1] Accordingly, without adequate consideration of the case of natural scarcity, a cost theory is the one which prevails in Smith's mind. As suggested in the preceding quotations, cost is thought of as labor expenditure, — the cost of toil and trouble. "Labour was the first price, the original purchase money that was paid for all things. It was . . . by labour, that all the wealth of the world was originally purchased."

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[1] Not marginal utility, but general capacity to satisfy wants regardless of supply, — total utility.

[2] E.g., Brentano, *Die Entwickelung der Werthlehre*, 1908, pp. 42–43.

Next it is to be observed that Smith distinguishes between the causes of value in early society and those in force after capital becomes important. In early society "the proportion between the quantities of labor necessary for acquiring different objects seems to be the only circumstance which can afford any rule for exchanging them for one another." [2] But after the "accumulation of stock" an element of profits must be allowed for: "Neither is the quantity of labour commonly employed in acquiring or producing any commodity, the only circumstance which can regulate the quantity which it ought commonly to purchase. . . . An additional quantity, it is evident, must be due for the profits of the stock." [3] Originally, then, labor cost regulated value; but when capital came to be used, profits must needs be allowed for. At other points, Smith resolves price into wages, profits, and rent. In civilized countries land and capital contribute to the "exchangeable value" of commodities; consequently the total value of the nation's products will command much more labor than entered into its production.[4]

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[1] Bk. I, Chap. V (Cannan's ed., p. 32).

[2] Bk. I, Chap. VI (Cannan's ed., p. 49).

[3] Bk. I, Chap. VI (Cannan's ed., p. 49). "Of the Component Parts of the Price of Commodities."

[4] Bk. I, Chap. VI (Cannan's ed., p. 56).

✓ But while pursuing this thread of thought, the reader of the *Wealth of Nations* is struck with another use of the labor element in regard to value. For example, it is stated that the value in exchange of any commodity "is equal to the quantity of labour which it enables him [the owner] to purchase or command. Labour, therefore, is the real measure of the exchangeable value of all commodities."[1] Here the idea obviously is that labor is the *measure* of value: what a thing is worth may be learned by finding out how much labor it will "command."

At several points the two ideas, labor as cause or determinant *vs.* labor as measure, are brought into juxtaposition. At the very outset, the twofold aspect is suggested in the statement that the fund of national wealth consists "either in [1] the immediate produce of that labor, or in [2] what is purchased with that produce from other nations."[2] Then the distinction appears clearly in the following sentence: ". . . [1] the quantity of labour commonly employed in acquiring or producing any commodity, is the only circumstance which can regulate [2] the quantity of labour which it ought commonly to purchase, command, or exchange for."[3]

In short, in order to understand Smith's theory of value it seems absolutely necessary to keep in mind the distinction between cause and determinant on the one hand, and measure, on the other. On the one hand, labor is ~~spoken of~~ as an amount of toil or trouble of acquirement, as a quantity employed in production, "what it really costs the person who brings it to market," etc. These things "*regulate*" value, while the quantity of labor a thing exchanges for is "the real *measure*" of exchange value. To what extent this distinction was consciously made by Adam Smith cannot be said, but it seems more than mere chance that the usage is so consistent.

✓ Of the two ways of looking at the problem, the labor-cost-determinant is the more fundamental. It is the labor required in production that so limits the supply of a produceable commodity as to insure a purchasing power, some use for it being assumed.

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[1] Bk. I, Chap. V (Cannan's ed., p. 32).
[2] Introduction (Cannan's ed., p. 1).
[3] Bk. I, Chap. VI (Cannan's ed., pp. 49–50).

That Smith had it in mind that what determines the amount of labor a thing will command is the amount of labor (and capital, after the accumulation of stock) it contains, is quite clear. Before the accumulation of stock, etc., if division of labor had been carried out, goods "would have been produced by a smaller quantity of labour; and as the commodities produced by equal quantities of labour would naturally in this state of things be exchanged for one another, they would have been purchased likewise with the produce of a smaller quantity."[1] Or, speaking of precious metals, he remarks, "As it costs less [1] labour to bring those metals from the mine to the market, so when they were brought thither they could [2] purchase or command less labour."[2]

This being so, how are we to express the amount of purchasing power or value in the commodity? As labor ceases to be the sole cost this question becomes of increased significance. Money and corn so vary in this power to command other commodities that they are hardly suitable, so Smith resorts to labor again, this time as a measure. Under ordinary conditions the laborer "must always lay down the same portion of his ease, his liberty, and his happiness." He may receive more or less goods, but the labor price he pays for them remains the same: their value varies, not that of the labor which purchases them.[3]

It is perhaps worthy of note that the concept of labor as the measure of value becomes more and more prominent as Smith develops his idea of an advanced state of society in which labor is not the whole purchase price of goods.

It is to be regretted that Smith was not more clearly conscious of the distinction between the causation and the measurement of value. If he had understood that the ascertainment of the cause of the quality of being valuable does not necessarily afford a means of measuring the quantity of value, he might have given us a more satisfactory explanation of why different things have different quantities of value, — which is the problem of the determination of value.

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[1] Bk. I, Chap. VIII (Cannan's ed., p. 66).
[2] Bk. I, Chap. V (Cannan's ed., p. 34).
[3] Bk. I, Chap. V (Cannan's ed., p. 35).

Such being the basis for his cost theory of objective exchange value, the question as to its application and serviceableness arises. Smith himself states that values are not adjusted by any accurate measure, but according to a rough approximation to equality, through the higgling of the market. His idea is that the *average* labor cost may be used. Taking the laborer of ordinary or average skill, strength, and health, a day's work will always involve the same amount of disutility, — the same sacrifice of ease, liberty, and happiness. In Chapter VI he makes allowance for the difference in hardship, skill, etc., characteristic of different occupations; and, while steering perilously near to introducing a discordant utility element, he concludes that frequently the compensation for skill is equivalent to one for the time and labor spent in acquiring skill.

Smith did not have the idea of marginal costs to fall back upon. Instead, he uses the device of an average man under average circumstances. If this use of the average man be considered, and if it be remembered, furthermore, that Smith seeks to determine value only indirectly and through cost, his reasoning does not seem to be open to criticism on the ground of a lack of homogeneity in environmental conditions, or in quality of labor, in so far as a given occupation is concerned.[1] The conception of an average labor cost under average conditions for an average workman of a given grade, seems impracticable and even unreal, but does not appear illogical.

Nor is he inconsistent in his use of corn, money, and labor as measures; for he takes up the two former as merely the more expedient, basing their validity upon their ability to command labor.

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[1] But cf. Davenport, *Value and Distribution*, p. 9. See below, pp. 492–494, where Marx takes up this same problem.

(Holding the idea he did of value as an objective exchange relation, however, his quest of a long-time or absolute standard is inconsistent.)

/ [It remains to be noted that Smith made the distinction between *natural price* and *market price.* When the price just covers the ordinary rate of rent, wages, and profits expended in preparing and marketing the commodity, it sells at its "natural price." The market price may be above or below this, depending upon the supply actually on the market and the "effectual demand" — the demand of those who were willing to pay the natural price.[1]] "The natural price itself varies with the natural rate of each of its component parts, of wages, profit, and rent; and in every society this rate varies according to their circumstances, according to their riches or poverty, their advancing, stationary, or declining condition." [2] Smith also suggests the importance of demand as determining supply.

~~The Classes~~ of Society and Their Interests. — According to Smith, there are *three great original constituent orders* of civilized society: they consist of those who live by rent, those who live by wages, and those who live by profit. Others derive their revenue from these. The interests of these classes may diverge one from the other, and from the general interest of society. That of the rent-takers, however, is connected inseparably with the social interest, and might safely be taken as a guide for legislation.[3] But as their revenue requires neither labor nor care, they are indolent and unsuited for public office. Likewise, the interests of the wage earners are strictly connected with those of society, but so ignorant are they that they cannot understand their own or society's needs, and their voice has small weight. The third order of men, those who live by profit, have interests quite at variance with those of society. They necessarily desire to narrow competition. They are acute, but selfish, and commercial legislation proposed by them should be regarded with suspicion.[1]

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[1] Bk. I, Chap. VII (Cannan's ed., p. 58).

[2] *Ibid.* (Cannan's ed., p. 65).

[3] This was not consciously so with the landlord. "It is to no purpose that the proud and unfeeling landlord views his extensive fields, and, without a thought for the wants of his brethren, in imagination consumes, himself, the whole harvest that grows upon them." (*Theory of Moral Sentiments*, pp. 348 ff., 1st ed.)

The determination of the shares of these orders, then, beginning with wages, is the problem to be considered next.

✓**Wages.** — As in many other instances, so in his statements on wages, Smith is not clear-cut. ✓In the *Wealth of Nations*, may be found traces of virtually every wage theory ever developed. In general, however, his doctrine is that wages depend on labor supply and demand. On the one hand, the supply is limited and a minimum is set by the price of the necessaries and conveniences of life, or, as he puts it in another place, by the "ordinary or average price of provisions." [2] On the other hand, is the demand for labor, which depends on the surplus stock of the nation, or the national wealth. The increase in this stock is the important thing. If there be an advancing state of society, the demand is great and wages are high.[3] If there be a relative increase in any trade, there will be a rise of wages in it.[4]

By "necessaries," Smith understood "whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without." [5]

✓While he argued that in Great Britain wages were considerably above the subsistence level, yet he held that in the stationary state of society laborers would "naturally multiply beyond their employment," and wages soon be reduced to the lowest level "consistent with common humanity." [6]

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[1] *Wealth of Nations*, Bk. I, Chap. XI, conclusion (Cannan's ed., p. 249).

[2] Bk. V, Chap. II, part ii, art. iii (Cannan's ed., p. 348).

[3] Bk. I, Chap. VIII (Cannan's ed., p. 71, *et passim*).

[4] Bk. I, Chap. X, part ii, 3d argument (Cannan's ed., p. 136).

[5] Bk. V, Chap. II, part ii, art. iv (Cannan's ed., p. 354).

[6] The pessimistic effect of such passages is evidenced by the following quotation from Weyland's *Population and Production*, 1816. ". . . it follows that it is also our duty to use every exertion for the purpose of preventing a country from resting in the stationary condition, which Dr. Smith designates as 'hard' and 'dull,' or from sinking into the declining state, which is described as 'miserable' and 'melancholy'" (p. 5).

Indeed, anticipations of Malthusianism appear more than once.[1]

Moreover, certain passages plainly suggest the wages-fund idea. "The demand for those who live by wages, it is evident, cannot increase but in proportion to the increase of the funds which are destined for the payment of wages," these funds being the employers' revenue surplus over their own subsistence and any "stock" not necessary for their own employment.[2] And again he speaks of "the funds destined for the payment of wages."

There can be no doubt that Adam Smith was very well disposed toward laborers as a class. As forming the greater part of society, what benefited them could hardly harm the whole. No society could be truly flourishing and happy, with its laboring classes poor and miserable. "It is but equity, besides, that they who feed, cloath, and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed, and lodged." [3]

As one turns the pages of the *Wealth of Nations*, and observes its lack of system, it is easy to see how the Socialists have drawn inspiration from its words. To begin with, there is a deductive, naïve account of early society. In this stage, or "originally," as Smith generally says, everything is bought with labor, and everything belongs to the laborer. Then comes appropriation of land, — and we are reminded that the landowner loves to reap where he has not sown. And, thirdly, accumulation of stock follows. At points, his words suggest that these agencies take a part of what labor really produces. The last quotation, for example, does so. But it is only a superficial reading that allows such a conclusion. Smith clearly states that capital is necessary to manufacturers, and trade to the convenience of society, implying its productivity.[1] And no one can well read the introduction to Book II and say that Smith denied either productivity or importance to capital, or that he desired a return to his original state.

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[1] "Every species of animals naturally multiplies in proportion to the means of their subsistence, and no species can ever multiply beyond it." Bk. I, Chap. VIII (Cannan's ed., p. 81).

[2] *Ibid.* (Cannan's ed., pp. 70–71).

[3] *Ibid.* (Cannan's ed., p. 80).

Profits and Interest.—"The increase of stock, which raises wages, tends to lower profit. When the stocks of many rich merchants are turned into the same trade, their mutual competition naturally tends to lower its profit; . . ."[2] These are the words with which Adam Smith explains the forces which determine profits. "They are regulated altogether by the value of the stock employed, and are greater or smaller in proportion to the extent of this stock," he says in another place.[3] The competition of capital keeps profits down,[4] and in an advancing state where wealth increases they are lowest, thus moving ordinarily in the opposite direction from wages.

The idea of a minimum rate is not clearly worked out. One may infer that if, from the lowest competitive price at which the dealer is likely to sell his goods for any considerable time, wages and rent are deducted, the remainder is profit.[5] "Unless they yield him this profit, . . . they do not repay him what they may very properly be said to have really cost him." More specifically, he says that the lowest ordinary rate of profit must be something more than what is sufficient to compensate the occasional losses to which the employment of stock is exposed.[6] Elsewhere he so writes that it may be inferred that profits must cover the costs incurred by the employing capitalist in advancing wages to his laborers; when the capitalist does not himself employ his capital, part of the profits naturally belongs to the borrower, who runs the risk and takes the trouble of employing the capital.[7] The other part in this case is *interest,* and Smith thinks its minimum "must be something *more* than sufficient to compensate the occasional losses to which lending, even with tolerable prudence, is exposed." [1]

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[1] Bk. II, Chap. V (Cannan's ed., pp. 340–341).

[2] Bk. I, Chap. IX (Cannan's ed., p. 89).

[3] Bk. I, Chap. VI (Cannan's ed., p. 50).

[4] Bk. I, Chap. IV (Cannan's ed., p. 335).

[5] Bk. I, Chap. VII. But profits may rise so high as to encroach on rent, Bk. I, Chap. IX (Cannan's ed., p. 98).

[6] Bk. I, Chap. IX (Cannan's ed., p. 97).

[7] Bk. I, Chap. VI (e.g., Cannan's ed., p. 54).

Smith is fairly consistent in using "profits" to indicate the return upon capital — what "can be made by the use of a capital," — while "interest" is a part of profits and refers to the price which can be paid by a borrower for the use of capital. His use of the terms "gross profit" and "neat or clear profit" is not very definite, it being left for his followers, Senior and Mill, to develop the analysis. He differs from them markedly in his distinction between wages of superintendence ("inspection and direction") and profits,[2] for he appears to exclude such wages from the latter return.

Two exceptions are made to the statement that wages and profits move in divergent directions: in new colonies both wages and profits may be high; and in the "stationary state" both wages and profits may be low.[3]

Profits so vary from day to day, by reason of change in prices and fortune, that it is impossible to determine their average rate; but some notion may be formed of their course from the interest of money, which they closely follow.

Rent. — In the *Wealth of Nations*, the treatment of land and rent begins with the well-known dictum that when the land of a nation has all been appropriated, the owners demand a rent even for its natural produce. The laborer then has to pay the landowner for the license to gather the fruits of the earth, giving the latter a part of what his labor collects or produces, that is, rent.[4]

This rent is the highest price which a tenant can pay his landlord. Its natural rate will leave the tenant only wages and profits. If the price of his produce yields him more than this, the landlord can and will exact it. "The rent of land, therefore, considered as the price paid for the use of land, is naturally a monopoly price."[1] This rent varies with the fertility and the situation of the land. If distant from the market, a greater amount of labor is required, and the surplus remaining for the landlord is diminished. Hence, good roads, canals, and rivers, equalize rents.

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[1] Bk. I, Chap. IX (Cannan's ed., p. 98); italics author's.

[2] Bk. I, Chap. VI, paragraphs 5 and 6 (Cannan's ed., p. 50).

[3] *Ibid.* In the latter case Smith must mean real wages, as the high prices of subsistence in the stationary state would cause high money wages.

[4] Bk. I, Chap. VI. Compare Hume's essay, *Of Interest.*

Except for calling the landowner a monopolist and his rent a monopoly return, the main outlines of Smith's treatment of rent as the income of the landowner, agree with more recent thought. It is in the discussion of the relation of rent to price that he is inconsistent. In the foregoing account of his theory of value, it was remarked that he included rent as a cost. Yet in his chapter on rent he makes its amount depend upon price rather than enter into the determination of price. This contradictory treatment seems inexcusable, for we know that Smith's attention was called to the error of making rent a price-determining cost along with wages and profits.[2] The explanation appears to be that, lacking the concept of the margin, in the first instance he confused the causes of higher prices for agricultural produce with rising rents. And it seems likely that there was a further confusion between the idea of entrepreneur's expenses and general (social) costs. Between the two, *he* became confused. In some cases, as, for example, in saying that the natural price of a commodity is the one just sufficient to pay rent, profits, and wages, he undoubtedly takes the individual business man's point of view. Again, when he says that the total produce of a nation, or its price, is divided into three parts, he merely has in mind the obvious fact that rent and wages and profits must all be paid from this total produce. But at other points, he speaks as if he is considering rent to be a deduction from labor's share, and to that extent to be substituted for the original labor cost of products. Rent would thus enter into the determination of value, as if in lieu of labor.

In any case, his ideas were not well formed, and he shifts his point of view. In this matter of the relation of rent to price, the philosopher-economist was working into new fields.

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[1] Bk. I, Chap. XI.

[2] In correspondence with Hume.

Public Finance. — Smith points out two sources of public revenue: the funds, land, and capital of the state; and taxes. He favors the use of the latter alone. Then come the four celebrated canons of taxation: (1) taxes should be levied according to the ability of those who pay them; (2) their amount should be certain and known; (3) their levy should be in the manner most convenient for those taxed; (4) and they should be so contrived as to be most economically collected.

Whether or not these canons of taxation were all original with Smith,[1] his formulation attracted great attention, and their influence, through his writing, has been notable.

Of course, all taxes must be drawn ultimately from rent, profits, or wages; and these sources are reviewed for the purpose of ascertaining the best, the conclusion being that capital and wages should not be taxed, directly, at least, and that rent forms the best basis. Assuming that profits are equalized by competition, a tax on this order of revenue would be borne by the consumer. In any case, it would be very difficult to assess and collect. (In this connection, too, Smith argues against taxing transfers of property by sale or inheritance.) As to wages, a tax on this share would, in the long run, fall on the consumer, — in fact, prices would be raised by an amount greater than that of the tax.

Thus rent remains as the most desirable source, and in the last analysis Smith's position is similar to that of the Physiocrats. But he differs from the proponents of the *impôt unique* in advocating taxes on luxuries. In this way, the capitalists and landowners might be reached as consumers.

In discussing the land tax, Smith, although he does not seem to suspect that he is disturbing the harmony of his system, allows several departures from the let-alone policy. It requires little reflection to show that levying taxes in such a way as to encourage one method of production and discourage another, is going very far in the way of governmental interference in private economic affairs. Thus when Smith favors taxing at a lower rate those landlords who cultivate their own lands, or levying a specially high rate on those who restrict the freedom of their tenants, he thereby advocates a virtual departure from *laisser faire.*[1]

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[1] See above. pp. 1[illegible]0, 210.

Government Interference: ***Laisser Faire.*** — In passing to Book V, "The Revenue of the Sovereign or Commonwealth," Smith takes occasion to make a formal statement of the important duties of the sovereign according to the "system of natural liberty." These duties or functions are as follows: (1) "the duty of protecting society from the violence and invasion of other independent societies; (2) the duty of protecting, as far as possible, every member of society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and (3) the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain, . . . though it may frequently do much more than repay it to a great society."[2] The three duties are, therefore, briefly: (1) protection against foreign states; (2) the administration of law and justice; (3) the establishment and maintenance of certain public works and institutions. Number (3) is divided into (*a*) the institutions and public works in favor of trade and commerce, as streets, canals, harbors, embassies, fortifications in countries belonging to barbarous peoples; (*b*) the education of the youth, i.e., a school system; (*c*) the education of the entire people, i.e., the Church.

The nation ought to be protected by a paid army subject to the authority of the king. Government in civilized states should make it the interest of a part of the people to become good soldiers. This matter may not be left to itself. Self-interest of private individuals is here an insufficient motive power.

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[1] Bk. V, Chap. II, Art. 1.

[2] Bk. IV, Chap. IX (Cannan's ed., p. 185).

The last two classes of duties should be performed *as far as possible* by the people acting under the impulse of self-interest: but the state must see that they are performed. Even judges, according to Smith, should compete with each other like merchants. Each one should strive to draw to himself the largest possible number of cases, and earn his living by court fees and stamp duties. The one who did most business should receive the most pay. Fees should be withheld from the judge until the process is determined, in order to incite the court to diligence and to expedite business. Streets should be kept in order by tolls; harbors by port duties. He holds that Church and State should be independent of each other.

The Church, the school, streets, harbors, and similar public works are beneficial to the entire society, and it would really be no injustice if society were required to defray the expense of their establishment and maintenance; but as they benefit especially those who use them immediately, it is to be recommended that such users pay for them. That Smith is able to take both views of the matter and allow that both may be perfectly right, shows how little inclined he was to be a mere doctrinaire.

Outside of these general social and economic functions, however, no inconsiderable dispute has existed over the extent to which Adam Smith favored government interference. Some have maintained that he held that the unrestrained action of selfishness leads to the highest attainable prosperity of the commonwealth; others, that he recognized the necessity of a considerable activity on the part of other forces for the attainment of the highest degree of prosperity.

The truth appears to be that in all ordinary cases, according to Smith's idea, the "natural" action of private self-interest leads to the most perfect organization of social and economic relations and to the greatest welfare of all. Thus he argues that "the patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbor, is a plain violation of this most sacred property.

. . . The affected anxiety of the lawgiver is evidently impertinent as it is oppressive." And again, he states that "every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage indeed and not that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is more advantageous to the society."

These excerpts seem to make Smith's position clear enough. But two modifications are to be noted: he states that class interests may run counter to those of society; and he admits several particular exceptions to the general principle of *laisser faire*. As to the former, it is a modification, not a contradiction, of the let-alone principle. That Smith did not believe in an entire harmony of class interests is true; but it does not follow that he should have called in the aid of the state authority, nor did he. The idea limits his optimistic conclusions rather than conflicts with his *laisser-faire* doctrine.

Put in concrete terms, the exceptional cases in which the government might properly interfere, were: —

a. *In Foreign Commerce.* — Taxes on imports were justifiable in order to make a nation self-sufficient in such things as saltpeter, and in shipping (Navigation Acts); and also, if goods produced at home were taxed, imports of these goods should bear a similar tax. If English products were taxed in foreign countries, it would then be "a matter of deliberation" whether foreign taxation could not be abolished by retaliatory duties. A duty on exports of wool was to be favored under certain circumstances.[1]

b. *In Banking.* — Where the liberty of a few endangers the liberty of the whole society, it ought to be restrained by law.[2]

c. *Interest Rates.* — Smith thought that the rate of interest should be legally fixed, though with due regard to the market rate.

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[1] Bk. IV, Chap. VIII (Cannan's ed., p. 152), several of these exceptions not allowed until 3d ed., 1784.

[2] Bk. II, Chap. II (Cannan's ed., p. 307).

✓d. *Education.* — In the case of those who could not afford an education, the government might profitably provide for free schooling.

✓Besides these, and the interference suggested in the taxation of rents,[1] there are certain places in which Smith expresses approval of interference by the state; as, for example, where he speaks of measures intended to regulate the relations between laborers and employers, in framing which the government takes advice of the latter only. He says of this case: "When the regulation, therefore, is in favor of the workman, it is always just and equitable. . . ."[2]

Philosophy and Method. — Some of the particular aspects of Adam Smith's philosophy have already been pointed out, — its assumption of the "natural," its self-interest basis, its let-alone policy. When, however, it comes to placing him in one or the other of the two great groups, Idealists and Materialists, the matter is not so simple. A well-known German economist, for instance, declares Adam Smith and Kant to be at one.[3] According to this view, he might be rated as an idealist. On the other hand, a great majority would consider the *Wealth of Nations* as dominated by materialistic tendencies. In so far as his belief about the natural tendencies of men in their industrial relations is concerned, the latter view appears sound. The fruits of its influence show it.

Yet just as his free trade teaching was not unqualified, s
philosophy displayed in the *Wealth of Nations* is far fro
plicity and consistency. Smith the practical man,
conclusions from the business world, Smith the thor
individualist, Smith narrowly limiting productivity
commodities and speaking of men as "other co
Smith of utilitarian tendencies, tended to emp

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[1] Above, p. 228.

[2] Bk. I, Chap. X, Pt. ii (Cannan's ed., p. 143).

[3] Oncken, *Adam Smith und Immanuel Kant* (1877)

[4] Bk. I, viii (Cannan's ed., p. 82). "It is in this
men, like that for any other commodity, necessaril
men."

things; and this was the dominant Smith. To this Smith, a man's career is determined by environment;[1] division of labor dominates character, rather than *vice versa;*[2] and men are the pawns in a great machine-like game of nature.[3] On the other hand, and half-concealed in the *Wealth of Nations* at least, there was another Smith who somewhat limited his optimistic individualism, who tacitly deduced conclusions from ideal postulates, who emphasized the social point of view, and who opposed duty and moral considerations to the "natural." This was the Smith who wrote the *Theory of Moral Sentiments,* and he shows clear traces of an idealistic tendency.

The difficulty in classifying Smith's underlying philosophy is undoubtedly due in part to the nature of the subject as he conceived it. To him, economics concerns the wealth of nations; economic activity lies in the pursuit of wealth, and chiefly material wealth; and the mainspring of economic activity is self-interest. Thus he abstracted economic life from other human activities and motives. As Bonar has admirably observed, his "system of natural liberty would not lead to perfect economy unless men are, for the sake of the argument, supposed to be infallible in judging their interests and single-minded in pursuing them."[4] It is, perhaps, true to say that Adam Smith's materialism lies more in his economic man than in himself, and, therefore, that any obloquy on this score harks back to his abstraction.

But Adam Smith can hardly be called a utilitarian in philosophy, though he gives the idea of self-interest greater play than did the Physiocrats. Like them, he had a metaphysical idea of a natural order. It is true that as a hard-headed Scotchman he could not go the full length the Physiocrats were willing to go in subordinating everything to this order. In any conflict between the "natural," on the one hand, and the expedient or practical, on the other, the latter won in Smith's mind. He tended to find justification for what was "useful." It may be said that his kind of nature philosophy was ultimately based on utility. He was no utilitarian, however, in the sense that Bentham, Ricardo, and Mill were: he was not so thoroughly rational in his thought, nor did he have the pleasure-and-pain calculus worked out by Bentham and Mill. His use of utility was veiled, as it were, by his nature philosophy.

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[1] Smith thought men were born with equal capacities.

[2] Bk. I, ii (Cannan's ed., pp. 7–8).

[3] See *Theory of Moral Sentiments,* pp. 290–292 (1st ed.).

According to Bonar, Adam Smith thought of industrial progress as nature's doing, not man's: "It was according to law, but not a law of man's making; indeed man could not try deliberately to make it without spoiling the work of nature." (*Philos. and Pol. Econ.,* p. 174.)

[4] *Philosophy and Political Economy,* p. 178.

In his *Theory of Moral Sentiments*, moreover, he makes virtue for its own sake a primary consideration.[1] Though, together with the Physiocrats, Smith was instrumental in bringing about a formal separation of Political Economy from so-called Moral Philosophy and Jurisprudence, — and this is one of his services, — his philosophy and that of his successors has an ethical element.[2] The assumed naturalness of perfect competition was the criterion. As a general proposition, if freedom to compete were encroached upon, the encroachment would be *wrong*. Their philosophy is in this regard, then, not unlike the just-price idea, "natural law" being substituted for the law of clergy or state.

On the score of method, the same duality appears, and one writer is found stating that Smith established "a deductive and demonstrative science," while another holds that the *Wealth of Nations* consists simply of practical and common-sense suggestions.

As long ago as 1870, Cliffe Leslie expressed the following analysis of Smith's reasoning which seems to be essentially sound: "An examination of Adam Smith's philosophy enables us to trace to its foundation the theory upon which the school in question has built its whole superstructure. The original foundation is in fact no other than that theory of nature which, descending through Roman jural philosophy from the speculations of Greece, taught that there is a simple Code of Nature which human institutions have disturbed, though its principles are distinctly visible through them, and a beneficial and harmonious natural order of things which appears wherever nature is left to itself. In the last century [the eighteenth] this theory assumed a variety of forms and disguises, all of them, however, involving one fundamental fallacy of reasoning, *a priori* from assumptions obtained, not by the interrogation, but by the anticipation of nature; what is assumed as nature being at bottom a mere conjecture respecting its constitution and arrangements. The political philosophy flowing from this ideal source presents to us sometimes an assumed state of nature or of society in its natural simplicity; sometimes an assumed natural tendency or order of events, and sometimes a law or principle of human nature; and these different aspects greatly thicken the confusion perpetually arising between the real and the ideal, between that which by the assumption ought to be, and that which actually is. The philosophy of Adam Smith, though combining an inductive investigation of the real order of things, is pervaded throughout by this theory of nature, in a form given to it by theology, by political history and by the cast of his own mind."

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[1] E.g., p. 203 (1st ed.).

[2] Indeed it is not free from theological premises. Cf. Leslie's Essay on the "Political Economy of Adam Smith," *Fortnightly Review*, Nov. 1, 1870; republished in *Essays in Political Economy and Moral Philosophy*.

Thus he assumes *a priori* the existence of an "original state" which is the "natural order." Moreover, certain instincts are derived by the same method, and their working in the original state is deduced. For example, men are assumed to have a natural propensity to "truck and barter," from which division of labor results. And, again, a desire to better his condition, and to live as much at his ease as possible, is taken for granted as characterizing every man.[1] Empiricism prevails over rationalism.

The conclusion is that Smith's underlying philosophy was individualistic, with a strongly materialistic tendency; but that it was hardly utilitarian, though containing the germs of utilitarianism and tending in that direction.

His method was a combination of induction and deduction, the latter predominating in his broadest and most fundamental reasonings.

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[1] Bk. II, Chap. III (Cannan's ed., p. 323).

Practical Influence. — Englishmen delight to call Adam Smith the Father of Political Economy. While it is possible that this title should be shared with Turgot and Quesnay, there is no doubt that the *Wealth of Nations* became the cornerstone of economic science. Those who went before, prepared the way for him; those who came after, carried on his work, either building upon the foundation of his thought, or endeavoring to correct his errors. Those who have not, have for the most part held that a positive science of economic value is impossible.

Buckle, who appears to have looked into the matter, said that the first notice of the *Wealth of Nations* in Parliament, so far as he knew, was in 1783, and that it was mentioned several times there between that date and the close of the century. After some intervening remarks he adds: "Well may it be said of Adam Smith, and that too without fear of contradiction, that this solitary Scotchman has, by the publication of one single work, contributed more towards the happiness of man than has been effected by the united abilities of all the statesmen and legislators of whom history has presented an authentic account." Even Bagehot says: "The life of almost every one in England — perhaps of every one — is different and better in consequence of it. No other form of political philosophy has ever had one thousandth part of the influence on us."

There can be no doubt that the political economy of Adam Smith has had a tremendous practical effect. The *Wealth of Nations* has been translated into the languages of all civilized peoples. It has almost everywhere directly or indirectly influenced legislation in a marked manner. In some countries, the influence of the principles it teaches has even been too great to be conducive to a sound growth of institutions. In England it passed through five editions while Smith still lived. In 1876 the centennial of its appearance was celebrated, and it is one of the very few books to which has been awarded the honor of a centenary commemoration.

The statesman, Pitt the younger, was a careful student and professed follower of Smith, modifying his policy to a certain extent so as to make it accord more clearly with the principles of the *Wealth of Nations.* Had circumstances permitted, he would gladly have gone farther in the direction pointed out in that work, but his plans were crossed by the French Revolution, as well as by the prejudice and ignorance of conservative England. "His power rested above all on the trading classes, and these were still persuaded that wealth meant gold and silver, and that commerce was best furthered by jealous monopolies." [1] Nevertheless, he effected a considerable number of important economic reforms. Holding with Adam Smith that in the arithmetic of taxation two and two instead of making four, sometimes make only one, he removed numerous customs duties and reduced others. He was thus able to diminish smuggling, and increase the revenues. Adam Smith had made special mention of the injustice of prohibiting the importation of Irish cattle into England to protect the English farmer, and this prohibition Pitt desired to abolish, as well as the heavy duties on imported Irish manufactures. One of his first measures as minister was an attempt to conciliate the Irish by removing the barriers which restricted their commerce with England. In 1800, after some early failures, he accomplished his purpose by the union of England and Ireland which provided for the ultimate freedom of commerce between the two islands.

The Manchester School. — This work of enfranchisement was carried on and consummated by the "Manchester School"; for when, in 1819, Parliament provided for a retention of some duties between England and Ireland, it was the Manchester Chamber of Commerce which so protested as to cause a retraction of that backward step. Although it involves a glance ahead into the nineteenth century, just a word concerning the school should be presented here.

The name "Manchester School" [2] applies to a group of men who were active in advocating free trade, and who believed that a heavy burden of proof rests upon those who would do away with *laisser faire* in any field. These men were most active between 1820 and 1850; their work centered largely in the propaganda of the Anti-Corn Law League; and, as the League consisted largely of prominent Manchester merchants and manufacturers, the Annual Reports of the Manchester Chamber of Commerce expressed their ideas. Richard Cobden and John Bright were their leaders. Although the chief immediate influence upon them came from Ricardo, they stood for a revolt against regulation and for a practical application of Adam Smith's ideas. Freedom, they reasoned, is the natural condition of the individual, and protection is a harmful restraint upon industry. It is incorrect, however, to think that as a whole, in opposing factory legislation, they overlooked humanitarian interests. The leaders of the group certainly favored regulation to protect children, while believing that adults should be free to contract. Through Bastiat, as will be seen, the school exerted considerable influence in France. In this manner was Smith's influence perpetuated.

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[1] J. R. Green's *History of the English People*, Vol. IV, Chap. III.

[2] On the Manchester School see Rogers, *Cobden and Political Opinion*, 1873; Prentice, *History of the Anti-Corn Law League*, 1853; Cobden's *Speeches*, edited by Bright and Rogers, 1870; Bright's *Speeches*, edited by Rogers, 1868.

Critical Estimate of Smith's *Wealth of Nations*. — An eminent follower of Adam Smith, N. W. Senior, summed up his work in the following terms: "The inquiry which Quesnay originated was pursued, and with still greater success, by Adam Smith. Smith was superior to Quesnay, and perhaps to every writer since the times of Aristotle, in the extent and accuracy of his knowledge. He was, on the whole, as original a thinker as Quesnay, without being equally subject to the common defect of original thinkers, a tendency to push his favorite theories to extremes; and in the far greater freedom then allowed to industry in Great Britain than in France, and in the greater publicity with us of the government receipt and expenditure, he possessed far greater advantages as an observer . . . assisted by a style unequalled in its attractiveness, he has almost completely superseded the labours of his predecessors." [1]

Though Smith's thought is justly praised for its moderation,

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[1] *Lectures on Political Economy*, 1852, p. 5.

✓and his style for its attractiveness, the careful reader notices not a few careless, ill-expressed utterances and many inconsistencies. Universal rules are given absolutely, only to be followed by important deviations; now a factor is cause, now effect, etc. In spite of his moderation, relatively to both predecessors and followers, too, an undue absolutism somewhat mars his reasoning. To this extent Senior's estimate must be modified. But on the whole it is eminently just.

With more specific reference to Smith's contribution to the material of economic thought, another well-known follower of his has said: "In adopting the discoveries of others, he has made them his own; he has demonstrated the truth of principles on which his predecessors had, in most cases, stumbled by chance; has separated them from the errors by which they were previously encumbered; has traced their remote consequences, and pointed out their limitations; has shown their practical importance and real value — their mutual dependence and relation; and has reduced them into a consistent, harmonious, and beautiful system."[1]

To part of this statement of the case, decided exception is to be taken, while much more is to be said. In some instances, as in the theory of value and rent, Smith does not trace remote consequences, nor does he show their dependence and relation. Certainly there is much lacking on the score of harmony and consistency.

Finally, a critic of Adam Smith makes the following true observation: "Smith's teaching brought into vogue an entirely different way of contemplating political economy. It did this, first of all, by freeing investigators' minds from the idea that the source of wealth is of a very simple nature," and then by emphasizing division of labor. "This, in turn, implied that production had not been carried on in accordance with the dictates of a natural economy, but for the market. . . . Smith's chief contribution to economic doctrine was his neatly rounded and bold notion that economic life was a concatenation of processes of exchange. Herein lay such originality as he possessed. He gave the finishing touches to the idea of the 'ordre naturel,' the harmonious encounter of numberless individual self-seeking economic activities."[1]

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[1] M'Culloch, *Discourse on the Science of Political Economy*, Edinburgh, 1825, p. 56.

In short, Adam Smith developed "the price system," or value economics. He got suggestions from the various English predecessors and contemporaries mentioned at the beginning of this chapter. He was helped by Cantillon and the Physiocrats. But "Smithianism" is closely identified with "the price system." It puts exchange value at the center of economic life, and regards production as governed by prices. It leads almost necessarily to the treatment of "distribution" as based upon some process of market valuation applied to the services of the "factors" of production, and having some relation to the price of the goods produced. This treatment was to be applied more fully by Smith's followers.

Of the host of adverse criticisms of Smith's reasoning, the following seem to be the most fundamentally important: —

✓(1) He was at bottom, in his economics, an essentially materialistic thinker. As Ingram says, "He does not keep in view the moral destination of our race, nor regard wealth as a means to the higher ends of life, and thus incurs, not altogether unjustly, the charge of materialism."

(2) His philosophy was over-individualistic. Its tendency was so to restrict the sphere of government activity — in spite of the particular exceptions he made — as to be the basis for harmful conclusions. This was in part the fruit of a reactionary negativism, which, though much less marked than that of the Physiocrats, was deep seated. At the same time, he was led into *too absolute* an assumption or defense of capitalistic "institutions" which would replace those of Medievalism and Mercantilism.

Furthermore, his "individual" is an unreal one — too much of an "economic man," dominated by the "self love" and shrewd reflective choices of a Scotch trader. This unreality was encouraged by Smith's resort to the "average" as distinguished from the "marginal" man.

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[1] Spann, O., *The History of Economics*, pp. 109–110. (N. Y. 1930, translated from 19th German edition.)

(3) His economics mixes individual and social points of view, and on the whole adopts that of the individual entrepreneur. This is a twofold criticism. (I) It is impossible to build a consistent theory of economic values on a mixed basis which shifts back and forth between (*a*) wealth and expenses as seen by the individual business man, and (*b*) welfare and human costs as seen by the social scientist. (II) For the most part, Smith proceeds from the entrepreneur point of view. He warns of clashes of interest, but for a solution he relies chiefly upon the self-interest of business men. He mentions "real costs"; but, without explanation, he shifts to contractual payments for wages and rent, and develops no theory of profits. "Capital" remains the funds of the capitalist employer.

(4) These traits were made more harmful by his absolutism of theory. In spite of bits of historical treatment, he had little of the concept of relativity, and was led to state his doctrines too narrowly and in too sweeping a fashion.

To be noted as particular evidence of concrete error, is his treatment both of the productivity of different kinds of labor, and of the relation of land rent to price.

Smith's chief services are mostly suggested in the above quotations. His breadth of view and catholicity were notable. Taking in most of what was best in English and French economic thought, he gave Political Economy a definition and distinct content that it had lacked. He brought labor and capital into prominence, along with the land factor emphasized by the Physiocrats. And, imperfect as it was, his discussion of value was a marked advance over that of any predecessor.

Before Smith, economic investigation was too largely taken up with the producer of wealth. The producer was the starting point. While himself dealing largely with production, Smith *started* from the standpoint of the consumer: "Consumption is the sole end and purpose of all production, and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer."[1] Though sometimes overlooked or unexpressed, this has been the ultimate standpoint of the English Classical School. Even though it has too often been forgotten, the welfare of all consumers has remained implicit in their economics as the ultimate test of institutions and policies.

This test works out through "exchange," and the measure is exchange value, which is thought of both as governing production and consumption, and as tending to bring them into the best correlation. Such is the synthesis which Smith's development of the price system suggested.

There are surprisingly few important economic ideas of which there is not some trace in the *Wealth of Nations*. For example, there is the theory of population. This idea Smith suggests, but he does not work it out. The great problem of political economy has been found in the distribution of wealth, and but little progress can be made in the solution of this problem until inquiry is made concerning the present, as well as probable future population among which wealth is to be divided, and also concerning the effects on its numbers to be expected from this or that distribution of wealth. Both Turgot and Adam Smith mentioned incidentally the effects of an increase of population upon the wages of the laboring classes; but they did not bring the matter forward prominently, nor did they make any attempt to discover and treat scientifically the laws governing such increase. This work was reserved for Malthus, whose thought will be examined in a near-by chapter.

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[1] *Wealth of Nations*, Bk. IV, Chap. VIII (Cannan's ed., p. 159).

II. THE EARLIER FOLLOWERS

As already indicated, the *Wealth of Nations* gained a rapid ascendancy and the dominant schools of economists in England and France soon came to call themselves the followers of Adam Smith. In Germany, too, Smith took the lead, though here his influence was not so quickly felt and a considerable degree of independence was early apparent. The Germans called this whole tendency *Smithianismus*. It is with these earlier followers of Smith's doctrines, in the late years of the eighteenth century and down to 1850, that this part of the work is to deal.

It will be helpful at this point to think of scientific economics as beginning with Adam Smith, who (with the aid of the Physiocrats) demarcated its field, and developed the concept of an automatic price system governed by laws. Out of Smithianism, there developed the English Classical economics, which had strong materialistic and pessimistic tendencies, and emphasized costs. This Classicism, however, was more than Smithianism. On the general foundation laid by Smith, certain main supports were erected by others, namely (1) Bentham's utilitarianism, (2) Malthus' doctrine of population, and (3) the Ricardian theory of value and distribution with its emphasis of labor cost and the land margin. In addition to Smithianism, therefore, we must now consider Benthamism, Malthusianism, and Ricardianism. This we will do in the next three chapters.

Immediately following Smith, between 1776, and the coming of Ricardo and the maturing of Malthus' thought — about 1815 —, not a few men conducted economic studies or wrote on economic subjects.[1] In England, however, only Lauderdale (1804) deserves any extended treatment, and he will be considered among the critics of Smith. Dugald Stewart (1753–1828), who studied under Adam Ferguson and succeeded him as professor of moral philosophy at Edinburgh, on the whole accepted Smith's ideas, though he was more sympathetic toward the Physiocrats and unlimited *laisser faire.* Stewart influenced Lauderdale and several English statesmen. William Spence is to be regarded as a minor controversial writer and advocate of reform. Arthur Young made inductive studies of agriculture, and Eden of pauperism. But none wrote anything which changed the course of economics or materially developed the science. No others need be mentioned here.

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[1] Cf. M'Culloch, *The Literature of Political Economy.*

This was a period of great disturbance and change. The factory system grew apace, and with it a new labor problem. The social problems of the day, aside from purely political issues, largely centered upon "poor laws," "corn laws" (protective tariffs), the slave trade, and depreciated currency. Concerning these, controversy raged, but no important works developing general economic principles appeared, other than those already mentioned.

We may therefore pass at once to Jeremy Bentham.

1. UTILITARIANISM

CHAPTER XI

BENTHAM AND HIS "PRINCIPLE OF UTILITY"[1]

Jeremy Bentham (1748–1832) was the son of a well-to-do English lawyer and was himself trained for the bar. He did not practice law, however, but devoted his life to study and writing. He traveled considerably, and was influenced much by French thought. His works were mostly translated into French.

Bentham, although not primarily an economist, influenced the development of economic thought so considerably, and in such an interesting way, that even a brief history of the science must discuss his contributions. Between the years 1787 and 1798 he published that part of his work which is most significant to the economist,[2] thus following Adam Smith by about a decade and preceding Ricardo. In addition to his publications, however, he was personally acquainted with James Mill and with Ricardo, and through both he influenced the thought of John Stuart Mill as well as others of their circle.

Although he published a work on Political Economy, Bentham's chief contributions to Economics lie in what he added to the philosophical, ethical, and psychological basis for the science. He was essentially a social philosopher, and was more interested in government and law than in economics.

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[1] An eleven-volume edition of the works and life of Bentham by Bowring appeared in 1838 and following years. See also *Bentham*, ed. by Raffalovich in "Petite Bibliotheque Économique" (Guillaumin), 1888. On Bentham's thought, see article by Bonar in Palgrave's *Dictionary of Pol. Econ.;* Mill, J. S., *Dissertations and Discussions*, I, pp. 330; Sidgwick, H., *History of Ethics;* L. Stephen, *The English Utilitarians* (1900); C. M. Atkinson, *Jeremy Bentham* (1905); Graham Wallas, *Jeremy Bentham* (1922); Patterson, *Readings in the History of Economic Thought*, pp. 178–190.

[2] *Defense of Usury* (1787); *Principles of Morals and Legislation* (1789); *Protest against Law Taxes* (1795); *Observations on the Poor Bill of Mr. Pitt* (1797); *Manual of Political Economy* (1798). Bentham's first publication appears to have been *A Fragment on Government* (1776) in which he criticized Blackstone. The larger part of his writings after 1798 dealt with legislative and judicial reforms.

Probably we should class as most fundamental in Bentham's thought his hedonistic psychology. He thought that individual actions are motivated by desire for pleasure and dislike of pain, and governed by a calculated balancing of pleasures and pains. The process of motivation, as he saw it, is somewhat as follows: feelings of pleasure or pain, or both, control the emotions and "will"; the will then refers to the understanding, which calculates a balance and decides; then action follows. This is rational hedonism.

In order to maintain this position, Bentham had to believe that pleasures and pains are measurable, and he so held. But he saw the necessity of allowing for various "dimensions" of pleasure, and he admitted certain limitations or difficulties. Thus he said that pleasures differ in intensity, with degrees ranging from the faintest pleasurable feeling, which is equal to unity. Other differences lie in duration, certainty, propinquity, purity (degree of mixture with pain), fecundity (reacting to increase capacity for enjoyment), and extent (number of individuals participating). In this classification one sees suggestions of some of the phases of utility mentioned by Jevons and others,[1] and of the idea of "time preference."

As to the difficulties or limitations, Bentham himself questioned whether the feelings of different individuals are comparable, but concluded that we must assume that they are. Then there is the question, Can pleasures be so qualitatively different that they cannot be compared in quantity? Bentham resorts to the solution of a "common measure" or denominator in the shape of money!

The question as to different rates of variation in pleasure according to differences in the amounts of wealth or money possessed, was also raised, and Bentham came near to stating a law of diminishing utility. At one point, he says that we will come nearest to the truth by assuming that the individual's pleasure intensity varies with the amount of money he has.

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[1] Below, p. 596, Jevons rightly points out that Bentham's "dimensions" are not of the same order, and constitute a cross classification.

In his *Principles of the Civil Code* (Chapter VI), he argues that the happiness of an individual is not in proportion to his wealth, and that the greater the disproportion between two masses of wealth, the less probable an equal disproportion between the quantities of happiness enjoyed. Nevertheless, it cannot be said that he formulated the law, and he does not appear to have seen the significance of what we now call marginal utility.

Proceeding from this sort of a psychology, Bentham formulated that utilitarian system of ethics and government for which he is best known. The idea that men are governed by pleasures and pains, becomes the idea that they are governed by the "principle of utility," and that the state should act — or refuse to act — accordingly.

A utilitarian can assume that individuals desire pleasure, and that pleasure is "good" for individuals in an absolute sense. Or he can assume that individuals desire to survive, and tend so to act that their survival is aided. Bentham made the first assumption. Later utilitarians, as will appear in a subsequent chapter, under the influence of evolutionism, adopted the second assumption and made survival the test of "goodness." Bentham's utilitarianism is, accordingly, a hedonistic utilitarianism, which holds that that is "good" for the individual which gives him the greatest happiness. The test of greatest happiness decides what he *ought* to do, determining the difference between right and wrong. The words used by Bentham to indicate this test are "benefit, advantage, pleasure, good, or happiness," and they are thus taken to be virtually synonymous — a dubious assumption.

But Bentham goes beyond this conclusion, and derives from it a *social* ethics and a principle of government.[1] (1) He believes not only that the principle of utility governs what individuals *ought* to do, but also what they *shall* do. (2) He believes, moreover, that society is just an aggregation of individuals, and that government should therefore be guided by the same principle. Indeed, the community, he states, is a fictitious body, and the common interest can be understood only by understanding what is the interest of the individual. In fact, the interest of the community is merely "the sum of the interests of the several members who compose it," and the only way to ascertain that interest is to add individual A's pleasure-minus-pain to individual B's pleasure-minus-pain, and so on. This is the way to the greatest good of the greatest number.

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[1] See *Principles of Morals and Legislation*, Chap. I.

Following up this line of thought, we find Bentham reaching two conclusions of great importance in the development of economic thought. One is that "natural rights" do not exist. The other is the doctrine of *laisser faire.* He scoffs at the idea of natural rights, saying that rights depend upon the laws. He says the "social contract" is a fiction. He holds that all government is perpetuated by habit, after having been established by force.

All this furnishes the basis for his individualism and for his advocacy of *laisser faire* and free competition. We find Bentham making the celebrated statement that in order to increase the national wealth or enjoyment, the general rule is that "nothing ought to be done or attempted by government." His rule of government is, "Be quiet."

First, government action in economic matters is needless, because (*a*) the wealth of society is just the wealth of the individuals who compose it, and (*b*) no one knows the individual's interest so well as the individual himself. (It is not surprising to find Bentham at another point saying, "There is no true interest but individual interest" — a concept which is second only to the pleasure-pain calculus as the basic element in his thought, and one which raises a vital question for all social scientists.)

Second, he argues, government action is not merely inexpedient, it is pernicious. It involves restraints upon individuals, and "pain is the general concomitant of the sense of restraint, wherever it is experienced." Government subsidies and aids also involve taxes, "and taxes are the product of coercive laws applied to the most coercive purpose."

Bentham went so far as to argue that competition should be allowed almost unlimited freedom, for the reason that the distress caused to various individual competitors would be more than offset by the benefits of others, the tendency thus being toward the greatest good of the greatest number. In this connection, we note that Bentham criticized Adam Smith's concession that government should fix maximum rates of interest.

It must not be inferred from the foregoing simplified summary of Bentham's position either that he was an unqualified extremist, or that his thought was free from inconsistencies. In leading up to his dictum concerning government, "Be quiet," he specifically calls it the general rule which applies "without some special reason." He grants that some "agenda" by the state are allowable, as for example the granting of patents to inventors. He recommends as the best tax, escheats on estates which lack near relatives, and favors taxes on bankers and stock brokers. Above all, he recognizes the greatest happiness of the greatest number as being the proper aim of legislation, thus making a place for a "general interest." Let us see where this thought may lead.

Adam Smith had assumed that individuals in following their own interests are led (perhaps as by a divine hand) unconsciously so to act as to make for the public good — at least in economic matters. Bentham, however, broke away from this optimistic "nature philosophy." He sought to make utilitarianism a rational principle which would serve to guide the law maker — a principle which would be consciously adopted and universally applied. This idea seems to involve the assumption that the individual ruler or legislator can rise above his own self-interest, and can both conceive of the general interest, and perform all the complicated pleasure-and-pain bookkeeping required to strike a balance for his "community."

Of course, Bentham would preface any such talk by saying "*if* there is to be any government regulation." But is it not fair to ask the question, if the ruler *can* have such an "aim" as Bentham grants (and can carry out the difficult processes involved in attaining it), why stop at patent laws, and the like? Why not go ahead and have complete social planning? Bentham reduced happiness largely to terms of quantities of pleasure. He thought that the greater the equality in the "masses" of wealth possessed by individuals, the greater the chances of equality in happiness. These ideas not only prepare the way for a sort of mechanical quantitative treatment of social problems; but also they suggest a simplification of the ruler's problem and the possibility of maximizing human happiness by a process of regimentation and control over wealth distribution — although these would have been most repugnant to Bentham.

Then comes in the ethical aspect of his "principle of utility" — one that most scientific economists would avoid — and with the "ought" comes the normative program! We may find in Bentham's thought traces of the following steps: first, the conclusion that the largest quantity of net pleasure is good and *ought* to govern individual action; second, men do in fact calculate pleasures and pains and act on that basis; third, prejudices, sinister interests, and ignorance may prevent the best balance; fourth, the next step may easily be the establishment of a social ought, involving legislative "aims," duties of rulers to act for the "general interest," and suggestions for equalizing wealth distribution, as by taxation. He thought of the principle of utility as determining an "object" — the object of a rational system which is "to rear the fabric of felicity by the hands of reason and law."

As a matter of fact, there was much of the reformer in Bentham. He believed that education of the individual is required in order to improve his calculation of pleasures and pains, and suggests laws to inflict pain on individuals who act so as to cause more pain to others than pleasure to themselves. This line of thought contains a strain of idealism which is not easy to reconcile with Bentham's underlying materialism, and shows that his extreme of individualism could easily lead into the other extreme of societism. In the last analysis, it was leading him away from *laisser faire.*

For example, while he regarded government as coercion and all coercion as bad, his quantitative balancing of pleasures and pains involved a choice of evils, and the maximum pleasure might be attained by government actions designed to reduce the pains of many at the expense of increased pains for a few.

Such were the expressed ideas, and some of the implications and tendencies of what came to be known as "Benthamism." These deeply influenced a considerable group of liberal thinkers or "philosophical radicals." To a large extent, the effects were negative, in that the Benthamites centered attention on legislative reforms in the shape of abolishing harmful restrictions and outworn legal and political institutions which constituted the great social problems of their time. They had much to do with repealing the prohibitions against labor combinations and the corn laws, and with the improvement of the poor laws. But, as will appear later in discussing John Stuart Mill, their thought also led to suggestions of positive reforms.

While Bentham accepted the economics of Adam Smith, rejecting only Smith's proposal to regulate the interest rate, Benthamism was very different from Smithianism.

In the first place, it casts out the "nature philosophy," and substitutes rational tests for metaphysical assumptions.

In the second place, it is more purely hedonistic, and goes further in basing economic action upon rational choices as against instincts and emotions.

In the third place, it mixes ethics and moral philosophy with economics, and tends to turn the latter into a sociology.

Bentham will ever hold a memorable place in the history of economic thought as one who dealt a great blow to the nature philosophy, who developed rational utilitarianism as the basis for a more positive freedom in economic life, thus influencing John Stuart Mill, and who suggested the idea of degrees of utility and their measurement to Jevons.

2. PESSIMISTIC TENDENCIES

It has been suggested that there were both optimistic and pessimistic tendencies embedded in the *Wealth of Nations.* Thus the idea that through self-interest men are led, as by a divine hand, so to act as to insure the best economic results for society, is taught by Smith, and has been at the bottom of a large part of the optimism in economic thought. On the other hand, the doctrine that the interests of various classes clash with one another, and with those of society, may lead to pessimistic conclusions, though not necessarily. Moreover, in believing that every nation must at some time reach a "stationary state," Smith profoundly affected succeeding economic thinkers and opened the door for many pessimistic doctrines.

Accordingly, in what follows, two groups have been distinguished among the general adherents of Smith's teachings: those who fell in with the optimistic tendencies; and those who developed the pessimistic side. Perhaps one's views may be colorless as to optimism and pessimism. Certainly some of Smith's followers do not fall clearly in either group, and a third category has been retained for such.

Probably the pessimistic tendencies were developed earliest; and such tendencies appear in the thought of one of his first English followers, Malthus.

CHAPTER XII

MALTHUS AND THE THEORY OF POPULATION[1]

✓One of the greatest among Adam Smith's followers was Thomas Robert Malthus. There were others who lived about the same time, as Dugald Stewart and M'Culloch, who made some name for themselves as economists; but they added nothing essential: if their work should perish, it would occasion no perceptible gap in economic thought. Malthus is the first English economist after Smith, a consideration of whose thought falls within the scope of these chapters.

Life and Circumstances. — Malthus was born in Rockery, County Surrey, England, in 1766, and came of very respectable family. His father, Daniel Malthus, if not a man of wealth, appears at least to have lived in very comfortable circumstances. Young Malthus studied philosophy and theology at Cambridge, graduating with honors in 1788, and was made Fellow of Jesus College not long afterwards. After leaving Cambridge, he took charge of a small parish in his native county. In 1799 he left England for a trip on the Continent in company with Daniel Clarke, a traveler of some note. On account of the war then disturbing Europe, he could see comparatively few countries, and those not the most important ones. He traveled through Sweden, Norway, Finland, and Russia. The notes scattered throughout his writings show what good use he made of his opportunities for observation. The Peace of Amiens in 1802 enabled Malthus to visit France, Switzerland, and other parts of Europe which he was unable to see on his first tour. In 1805, he was made professor of history and political economy in the college of the East India Company at Haileybury, near London, and retained the position until his death in 1834.

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[1] On Malthus and his work see Bonar, *Malthus and His Work*, 1885; Fetter *Versuch einer Bevölkerungslehre* (Jena, 1894), and "The Essay of Malthus, a Centennial Review" (in *Yale Review*, August, 1898); Marshall, A., *Principles of Economics*, Bk. IV, Chap. IV, §§ 3–7; Hadley, *Economics*, §§ 47–60; Cannan *Theories of Production and Distribution;* Gide-Rist, *Histoire des doctrines économiques* (1909), pp. 138 ff. and the following footnote references.

Of more importance, perhaps, than any one factor in shaping Malthus' thought was the condition of England just prior to and during the time at which he wrote. During the first half of the eighteenth century, the agricultural prosperity of England had been great; but toward the end of the century such distress prevailed that it seemed as if there were too many people for the land to support. Thorold Rogers, in another connection, testifies that during the last thirty years of the eighteenth century circumstances had totally changed: "There is . . . reason to believe that the increase of population was arrested. Prices rose,[1] and, at least while this country was at war with nearly the whole civilized world, the nation well-nigh suffered the horrors of famine. During the whole of that war, the country seemed to be passing through one of those cycles of scanty crops which appear to occur in some undefined but mysterious fashion." [2] Other reports only confirm these statements.

Of the state of Ireland at this time — a country mentioned by Malthus as furnishing a case of overpopulation — the historian Green writes: "Poverty was added to the curse of misgovernment, and poverty deepened with the rapid growth of the native population till famine turned the country into a hell." [3]

The evil effects of the Industrial Revolution had hardly come into view in Smith's day, but even when Malthus wrote his first edition they had manifested themselves. Unemployment, poverty, disease, and riot were among them. They made the agricultural situation still more significant of evil.

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[1] Average prices of wheat per quarter by decades: —

1771–1780	34*s.* 7*d.*
1781–1790	37*s.* 1*d.*
1791–1800	63*s.* 6*d.*
1801–1810	83*s.* 11*d.*
1811–1820	87*s.* 6*d.*

[2] Introduction to Adam Smith's *Wealth of Nations.*

[3] *Short History of the English People*, p. 788.

Partly as a result of these evils, various socialistic or communistic schemes, springing up chiefly on French soil, began to be urged.

To add to the whole dark picture, the English Poor Law was defective, both in substance and administration. The rates were enormously high, the independence of the laborer was sapped, and a premium was placed upon incompetence and pauperism.

Surely the conditions of the growth of population required investigation. Not the needs of some far-off place and time, but the requirements of his own age and country, gave Malthus his life work. Like so many great men, he had a preëminently practical interest.

It has appeared that it was a Mercantilist notion that a very dense population is desirable. Well down to Malthus' day, it was a general belief that a rapid growth in population meant prosperity. This opinion is apt to arise in times of war, and people were doubtless led to accept it by observing that the wealthiest and strongest countries were often the most populous. Such a view was developed by the German economist Süssmilch, whose work — *Die Göttliche Ordnung in den Veranderungen des menschlichen Geschlechts*, 1742 [1] — appears to have been diligently studied by Malthus. And Sonnenfels constructed his social system around this idea.[2] In many German cities, the married state was a condition of holding office, and similar schemes were proposed in England. In Malthus' day the government and the employing classes, generally favored a denser population, the one to fill the army, the other its factories.

His Forerunners.[3] — To be sure, Malthus did not originate the idea that population tends to increase faster than subsistence, nor that the increase in population brings hardship. In the preparation of his first essay (1798), he made use of the works of Wallace, Hume, Smith, and Price; while in the second edition he noted with some surprise that much had been done by Montesquieu, Franklin,[1] Stewart, Young, and Townsend. Dr. Robert Wallace, for example, in his *Various Prospects of Mankind, Nature, and Providence* (1761), saw a fatal objection to communism in "the excessive population that would ensue"; Smith's suggestions have already been referred to;[2] and the Rev. Joseph Townsend anticipated Malthus in observing that, where reason does not interfere, plenty is followed by increased population, want, and a higher death rate.[3]

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[1] See Roscher, *Gesch. d. Nat. Oek.*, pp. 421–424. Sussmilch was an economist of Mercantilist leanings. He dealt with birth and death rates, the proportion of the population of various ages, etc., his service being the development of the idea of regularities or laws. He was acquainted with Petty's writings. He showed strong theological influences, taking as a text the Biblical injunction to be fruitful and multiply.

[2] *Grundsätze der Polizei, Handlung- u. Finanzwissenschaft*, Vienna, 1765.

[3] See Bonar, J., *Theories of Population from Raleigh to Arthur Young*, 1931.

Malthus as a boy seems to have met Jean Jacques Rousseau, and his father, Daniel Malthus, was Rousseau's literary executor. He was personally acquainted with David Hume, and the latter must have exercised some direct influence over him. Indeed, in one of his essays, Hume had attempted to estimate the populations of some of the states of classical antiquity;[4] and Malthus, by calculating the food supply available to those states, undertook to test those estimates and the statistics of the Greek historians.

The *Essay on Population:* Its Origin and First Edition. — The more immediate cause of the *Essay on Population* was furnished by the writings of William Godwin, a well-known Englishman of the eighteenth century. In 1793, Godwin had published a work entitled *Enquiry concerning Political Justice and its Influence on Morals and Happiness*, which at the time created a great sensation. Its thesis was the perfectibility of man. In it, Godwin took the ground that government — which he described as a necessary evil — is to blame for the unhappiness and misfortunes of man. He argued against private property. The book was much discussed, and of course found its advocates and opponents. Among the former, was Daniel Malthus; among the latter, Thomas Robert, the son. Godwin published in 1797 a number of essays in the form of a book, entitled *Enquirer*.

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[1] Malthus cites the following remarkable passage in Benjamin Franklin's *Essay on the Increase of Mankind* (1751): "There is, in short, no bound to the prolific nature of plants or animals, but what is made by their crowding and interfering with each other's means of subsistence. Was the face of the earth vacant of other plants, it might be gradually sowed and overspread with one kind only, as, for instance, with fennel; and, were it empty of other inhabitants, it might in a few ages be replenished with one nation only, as, for instance, with Englishmen."

[2] Above, p. 224.

[3] *Dissertation on the Poor Law*, 1786.

[4] *Essay on the Populousness of Ancient Nations* (1752).

It was in reply to one of these, on *Avarice and Prodigality*, that Malthus, in 1798, published the first edition of his famous *Essay on the Principle of Population; or, a View of its Past and Present Effects on Human Happiness; with an Enquiry into our Prospects respecting the Future Removal or Mitigation of the Evils which it Occasions.*[1] Malthus sought to show that an abolition of government could not restore us to Eden, because the cause of unhappiness and misfortune is to be found in our weak and imperfect natures.

The first edition of the *Essay* attracted the widest attention, and led Malthus to continue his investigations. As successive editions were called for, they were revised and enlarged, until the last edition of the work published during his lifetime — the sixth, in 1828 — differed very materially from the original essay.

By reason of the occasion, the first edition was little more than a controversial pamphlet, and was not unnaturally put forth anonymously. Godwin had written: "There is a principle in human society, by which population is perpetually kept down to the level of the means of subsistence. Thus among the wandering tribes of America and Asia, we never find through the lapse of ages that population has so increased as to render necessary the cultivation of the earth." And he held that the system of private property then existing was the cause of unhappiness. He argued for a future equality of property, his doctrine being a sort of enlightened anarchism.

Malthus retorted, "This principle, which Mr. Godwin thus mentions as some mysterious and occult source . . . will be found to be the grinding law of necessity; misery, and the fear of misery."[1] He held that human institutions, far from aggravating, had tended considerably to mitigate this misery, though they could never remove it.

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[1] This is the title of the 2d edition.

To this conclusion he was led by the assumption of two postulates or premises: (1) "that food is necessary to the existence of man"; (2) "that the passion between the sexes is necessary, and will remain nearly in its present state." Then, though not formally so stated, came a third postulate, largely a deduction from the two preceding, namely, "the power of population is indefinitely greater than the power in the earth to produce subsistence for men. Population, when unchecked, increases in a geometrical ratio. Subsistence only increases in an arithmetical ratio."[2] So ran the statement in the first edition.

It followed that certain checks must restrain the superior growth of population: a "preventive" check in the shape of a foresight of the difficulties of rearing a family; and "positive" checks in the shape of poverty, disease, war, and other forms of actual distress. Though he recognized that through foresight marriage might be postponed, he thought this would mean vice, which in turn would mean "misery." Thus a happy or perfect state of society could not be hoped for.

One has but to compare the prefaces of the first and second editions to ascertain the essentials of the now classical development in Malthus' thought. In the former, he emphasizes a possible future improvement of society, and his view has a "melancholy" hue, there being "dark tints" in the picture. In the latter, he endeavors "to soften some of the harshest conclusions," and hopes he does not express any opinions concerning the future of society in which past experience does not bear him out. In the former, he is to adduce facts in connection with a virtually new particular inquiry into the means by which population is kept to the subsistence level; in the latter, he recognizes considerable previous thought on this phase of the question, and proposes to pursue the subject to its consequences and draw practical inferences. Finally, he remarks, "I have so far differed in principle . . . as to suppose another check to population possible which does not strictly come under the head either of vice or misery." The new check was virtuous abstention or "moral restraint": "that sentiment, whether virtue, prudence, or pride, which continually restrains the universality and frequent repetition of the marriage contract."

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[1] 1st ed., p. 176; Economic Classics Series, p. 47.

[2] 1st ed., Chap. I; Economic Classics Series, p. 7.

Thus the revised edition of 1803 was softened or toned down, and became an attempt at more scientific accuracy. In the attempt, as has been often observed, his ideas lost much of their novelty; while they gained in truth.

That the admission of the new check greatly weakens his argument against the possibility of social perfectibility, will be observed. It still has some force against communism, however, for "moral restraint" normally rests upon private property. Communism, properly speaking, means the abolition of private property even in consumption goods, and the sharing of social income on some basis of absolute equality of needs or wants. Under such a system, men as at present constituted could hardly feel the need for restraint so keenly as they do when their own property or income is at stake.

The Malthusian Principle as Developed in Later Editions. — a. *Tendencies of Population and Subsistence.* — With the foregoing developments in mind, Malthus' complete doctrine on the subject of population, as he expounded it in his later editions, may now be better appreciated.

The essence of these editions may be expressed in the following words: a review of the different states of society in which man has existed shows that population has a constant tendency to increase beyond the means of subsistence, and is kept to its necessary level by various positive and preventive checks, including "moral restraint."

This conclusion rests upon the "natural" operation of three factors: —

(1) Rate of increase (unchecked) of population based on sex instinct: Minimum = Geometrical ratio.

(2) Rate of increase of subsistence: Maximum = Arithmetical ratio.

(3) Checks on the increase of population.

The first two might be combined and be termed the ratio of the increase of population to the increase of subsistence; or, for any given time, the ratio of population to subsistence. As to the first, Malthus says: "It may safely be pronounced therefore, that population, *when unchecked*, goes on doubling itself every twenty-five years, or increases in a geometrical ratio."[1] His use of an assumed rate of increase of food appears in the following words: "It may be fairly pronounced therefore, that, *considering the present average state of the earth*, the means of subsistence, *under circumstances the most favorable to human industry*, could not possibly be made to increase *faster* than in an arithmetical ratio."[2]

Evidently, Malthus' theory leaned heavily upon the force of sex instinct. This force he assumes to work continuously and universally: "The cause to which I allude, is the constant tendency in all animated life to increase beyond the nourishment prepared for it."[3] Evidently, too, he assumes that the working of sex instinct necessarily means offspring and increased population, — either these or "vice" and "misery." It follows that the increase in population, being determined by sex instinct, is assumed to be continuous and uniform. Consequently, population tends to increase beyond any limit outside sex instinct. The limit upon which Malthus centers attention is "subsistence," meaning food. He assumed that food is the one necessity, saying, "But as by that law of our nature which makes food necessary to the life of man, population can never actually increase beyond the lowest nourishment capable of supporting it; a strong check on population, from the difficulty in acquiring food, must be constantly in operation" (p. 3).

Finally, the scheme is rounded out by concluding that comparison of the unrestrained natural increase of population with the increase in subsistence under the most favorable conditions, will enable us to judge the force of the "tendency" of population to outrun subsistence.

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[1] Bk. I, Chap. I, 2d ed.; present writer's italics.

[2] *Ibid.*, present writer's italics.

[3] *Ibid.*, p. 2.

The formula Malthus attempted to establish is often criticized as though the essence of the theory were dependent upon an arithmetical progression in the increase of food and a geometrical progression in the increase of population. This is not the case. The gist of the Malthusian doctrine is contained in the single sentence, "It is the constant tendency in all animated life to increase beyond the nourishment prepared for it." But the formula is often incorrectly given as follows: Population increases in a geometrical progression; the means of subsistence in an arithmetical. The disproportion resulting from the two different rates of increase must occasion wars, vice, and misery.

This representation is to be found nowhere in the writings of Malthus. In his later editions he speaks merely of a *tendency* of population. He means that every increase of population augments the power to increase; and, *the desire to increase being assumed,* that the increase will take place unless certain restraints are called into operation. As to the *possibility,* this is simply a physiological fact. Supposing that other things are equal, — although Malthus does not say that they are so, — it is easier for a population of four millions to add a million to its number and become five millions, than it is for one of one million to add a million to its number and become two millions. This is, it seems, essentially what Malthus meant by the statement that population has a "tendency" to increase in geometrical progression.

But how is it with the means of subsistence in so far as they depend upon the soil? — for agriculture as the source of raw material, and not manufactures, is of course referred to by Malthus in his law of population. Is the state of things here the same as it is in the case of population? Does every increase in the productive powers of land make it easier to augment still further its capability of production? Every farmer will tell you, no. If an acre of land which formerly yielded sixty bushels of potatoes is carefully improved until it produces eighty bushels, according to all experience it will not be easier to raise the crop from eighty to one hundred bushels than it was to bring it up to eighty from sixty bushels. It is not difficult to prove that it is not so easy. If a certain amount of care and labor will give a certain yield, e.g., of grain, and doubling that care and labor will double the yield, and if three times that amount of care and labor will treble the yield, and so on, it is evident that no one would care to increase the size of his grain farm. If this were not true, then a farmer who might be raising one hundred and fifty bushels of wheat from five acres, but who might wish to raise fifteen hundred bushels, would simply expend ten times the amount of care and labor on his five acres. This would be cheaper than buying forty-five additional acres of land, for fifty acres of land would require more work than the five had needed, and the farmer would have nothing to show for the money used in buying the forty-five acres. But, even allowing that it is just as easy to treble the original produce of land after it has been doubled, as it was to double it, and just as light a task to quadruple the original yield as it was to treble it after it had been doubled, we then have only an arithmetical progression. That is what Malthus meant by saying that food cannot possibly be made to increase more rapidly than in an arithmetical ratio.[1]

b. *Diminishing Returns.* — The foregoing argument clearly implies a law of diminishing returns from land. Malthus says, "It must be evident, to those who have the slightest acquaintance with agricultural subjects, that in proportion as cultivation is extended, the additions that could yearly be made to the former average produce must be gradually and regularly diminishing." [2]

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[1] Cannan takes Malthus severely to task on the basis of his first edition. This seems quite unwarranted. To publish a series of parallel and coördinate criticisms dealing indiscriminately with statements in different editions is, especially in Malthus' case, unjust, to say the least.

[2] As a yearly increase this implies an historical "law" rather than the accurate statement which begins, "at any given stage of the arts." But elsewhere Mal-

And elsewhere, speaking of an accidental depopulation, he remarks: "The diminished numbers would, of course, cultivate principally the more fertile parts of their territory, and not be obliged, as in their more populous state, to apply to ungrateful soils."[1] "When acre has been added to acre till all the fertile land is occupied, the yearly increase of food must depend upon the melioration of the land already in possession. This is a fund, which, from the nature of all soils, instead of increasing must be gradually diminishing."[2]

The law was not stated or developed by Malthus in his essay, however, and remained with him as a tacit assumption. The first of the two preceding quotations suggests that he had in mind an average diminution and lacked a concept of the margin.

c. *Checks to Population.* — Such being the nature of Malthus' teaching as to the relative tendencies of population and food supply to increase, it remains to analyze his "checks." If the cultivation of new lands and emigration do not afford sufficient means for counteracting the evil effects of the natural tendency of man to increase beyond the means of subsistence, and Malthus holds this to be the fact, what prevents overpopulation? The ultimate check is always to be found in the limitations on subsistence or food supply. This ultimate check, however, never operates directly except in times of famine.[3] The immediate checks include all diseases due to scarcity of subsistence, and all causes prematurely weakening the body. For conciseness' sake the Malthusian checks may be tabulated thus:[4]

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thus recognizes that agricultural improvement may offset diminishing returns. His error lay in minimizing the extent and continuity of such improvement and that in transportation. Cannan's criticism on this point (*Production and Distribution*, p. 144) seems rather superficial and hypercritical. The whole burden of Malthus' argument rests on a proportion between population and produce.

[1] 2d ed., p. 472.

[2] 5th ed., pp. 9–10.

[3] 5th ed., I, 17.

[4] Bk. I, Chap. II. Malthus himself does not specifically place checks "of a mixed nature" anywhere else than under the head "positive" (5th ed., I, 22). The author ventures in parenthesis to suggest what appears to be the logical conclusion.

I. Preventive; decreasing births:

(a) *Moral restraint.* — Postponement of marriage, unaccompanied by irregular gratification.

(b) *Vice.* — Promiscuous intercourse, unnatural passions, violations of the marriage bed, improper acts. (If *misery* results, these are of a "mixed nature," and become partly positive in action.)

II. Positive; resulting in shorter life:

(a) *Misery.* —

(1) Wars and excesses of human origin. (As of human origin, a form of *vice*, but operating positively.)

(2) Disease, famine, and other evils arising unavoidably from the laws of nature.

In his list of positive checks, he included unwholesome occupations, severe labor, extreme poverty, bad nursing of children, city life, and the like.

By "checks" to population, Malthus apparently meant any means of adjusting population to subsistence: "It will be allowed, that no country has hitherto been known, where the manners were so pure and simple, and the means of subsistence so abundant, that no check whatever has existed to early marriages from the difficulty of providing for a family; and no waste of human species has been occasioned afterwards by vicious customs, by towns, by unhealthy occupations, or too severe labor. Consequently, in no state that we have yet known, has the power[1] of population been left to exert itself with perfect freedom."

These "checks," however, are very heterogeneous in their nature, and some of them have no relation to subsistence. When population is fortuitously swept off by war or disease, is this a "check"? Hardly so, in the sense that it has any necessary or exact bearing on the relation between food and population. Is crowding in cities always due to limited subsistence? No; nor does the difficulty of providing for a family necessarily arise from any difference in rates of increase in population and food. These things have no significance, in themselves, as part of a "principle of population." In short, some of the so-called checks which Malthus relies upon are really outside his scheme, as they act neither on sex instinct nor on food supply.

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[1] Note that "power" of population to increase is not a "tendency" to increase.

Malthus admitted that certain customs and religious practices had operated to keep population down, and that without relation to food supply.

Social Results: the Malthusian Cycle. — Malthus maintained that no country ever had existed where morals and subsistence were such that population had been able to multiply with perfect freedom. In every country, checks were operative, yet, as he very moderately stated, *there were few states* in which population did not constantly "strive" to exceed subsistence. This fact constantly tended "to subject the lower classes of society to distress, and to prevent any great permanent melioration of their conditions."

In the generality of old states, Malthus held, there existed an oscillation or vibration in the relation between population and food. Assuming an equilibrium in which subsistence is just enough for the easy support of existing population, the order of precedence, as he saw it, begins with an "effort" of population to increase. Then subsistence becomes more divided. As a result, the number of poor grows, and those already poor fall into deeper poverty. The price of labor falls, the number of laborers being out of proportion to the work in the market; the price of provisions tends to rise. Then the difficulties of rearing a family discourage marriage, and population is brought nearly to a stand. But cultivators are meanwhile induced to employ more labor, and at last subsistence is brought up to a new equilibrium. Such is the normal and constantly recurring cycle. Malthus, however, admits that it is liable to irregularities on account of bad crops, new manufactures, greater or less spirit of agricultural enterprise, and emigration.

Malthus himself realized that the operation of his checks, as developed in the later editions of his work, did not necessarily mean great suffering. Speaking of the preventive check, he said: "If this restraint do not produce vice, as in many instances is the case, . . . it is undoubtedly the least evil that can arise from the principle of population . . . it must be allowed to produce a certain degree of temporary unhappiness; but evidently slight, compared with the evils which result from any of the other checks to population." [1] Moreover, he gives a little weight to emigration and considerable to agricultural improvement as counterbalancing the retrogressive tendency for longer or shorter periods of time. Accordingly, though evil exists, it need not bring despair, but activity. "When it follows in its natural order," — note the implications, — an increase in population may be regarded as beneficial and necessary for increasing the output of the nation. Malthus considered the "principle of population" as necessary to stimulate men to industry and progress.

But what "activity" did Malthus suggest? Not that of government through emigration, industrial supervision, and the like; but purely individual action: "each individual has the power of avoiding the evil consequences to himself and society resulting from the principle of population." [2] This power he may exercise by abstaining from marriage or any sexual intercourse until able to support a family. A major point in Malthus' theory is the idea that the postponement of marriage will increase the age at which marriages occur and reduce the number of children per marriage. And in an ideal society, too, no man whose earnings are sufficient to maintain only two children "would put himself in a situation" in which he might have to maintain four or five.[3]

Thus, by means of universal foresight, prudence, and virtuous abstinence, "all squalid poverty would be removed from society, or, at least, be confined to a very few, who had fallen into misfortunes against which no prudence or foresight could provide."

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[1] Bk. I, Chap. II, 2d ed.

[2] Appendix to 5th ed.

[3] Bk. IV, Chap. II, 2d ed.

While the foregoing statement is nearly complete, we would be doing an injustice to Malthus, were we to overlook various other remedies, varying in permanence, which he admitted in the second edition of his work. As a temporary expedient, he conceded that poor relief, if not such as to breed dependence, might do more good than harm (p. 587). More permanent relief is to be secured by education, improvement of cottages, giving free use of small tracts of land, and the establishment of savings institutions. Education, he believed, would prevent a man from burdening society with children which he could not support.

Other Economic Views.[1] — In brief mention of the more important and characteristic economic views held by Malthus, his treatment of rent and the interests of landlords, of overproduction, and of the measure of value should be noted. As will appear in the following chapter, he regarded rent as a surplus due to the bounty of nature, and in this differed with Ricardo. And a chief point is the distinction between rent and monopoly return, which he greatly emphasizes. Smith, Say, and others at points speak of the landlord as a monopolist reaping where he has not sown. Malthus, however, takes them to task. To be sure, the extent of the earth is limited and there is a relative scarcity of the better lands, and so land ownership might be referred to as a "partial monopoly."[2] But for three reasons, rent differs from the high prices set by a "common monopoly." First, and mainly, there is the quality of the soil, which enables it to yield a surplus over the amount required to maintain agricultural labor, or costs. This power is essential to rent, but is quite unconnected with monopoly. Secondly, the necessities of life which land yields, have the peculiar quality, when properly distributed, "of creating their own demand, or of raising up a number of demanders in proportion to the quantity of necessaries produced." The surplus has a power of "raising up a population to consume it," and in this, land is fundamentally different from any other machine. Finally, there is the comparative scarcity of fertile land. In "common monopolies," then, there is an "excess of price" over cost due to an external demand and depending upon the degree of monopoly; in the case of land the excess of price, or rent, "depends entirely upon the degree of fertility, natural or acquired." [1]

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[1] Other writings: —

An investigation of the Cause of the Present High Price of Provisions, containing an Illustration of the Nature and Limits of Fair Price in Times of Scarcity, 3d ed., 1800.

A letter to Samuel Whitehead on his proposed Bill for the amendment of the Poor Laws, 1807.

Inquiry into the Nature and Progress of Rent, 1815.

On the Policy of Restricting the Importation of Corn, 1815.

Political Economy, 1820.

The Measure of Value, 1823.

Definitions in Political Economy, 1827.

[2] *Political Economy*, 2d ed., p. 140.

Accordingly, Malthus thought the interests of the landlords were not in conflict with those of society, save as to importation. He thought them not separated from the interests of other producers, apparently forgetting that the peculiar significance of land and the produce of land which he had just dwelt upon, might make a difference.[2]

As to overproduction, Malthus differed with the majority of his contemporaries in believing it possible as a general condition, his moral being that there are limits to parsimony or saving.[3] He was clearly in error. His discussion of the point consists of a series of criticisms on the reasoning of his opponents, Say and Ricardo, the windings of which we need not follow. Now he is begging the question by assuming a fixed demand, now by assuming that an increase in demand must precede one in production; and ever and again he reasons aside from the point (*general* glut) by limiting the number of commodities in his illustrations. The service of such arguments as these has been to check the tendency to carry the general over to the particular, and to call attention to the friction and delay often involved in the working out of economic laws.

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[1] *Ibid.*, p. 147.

[2] *Ibid.*, p. 206.

[3] *Political Economy*, 2d ed., Bk. II, Chap. II, § 3 (pp. 106 ff.). It is to be noted, however, that he defines overproduction as involving production at less than cost.

In his first edition, Malthus took a mean between corn and labor as his measure of value. This he finally abandoned, accepting Adam Smith's labor-exchange measure.[1] He suggested dropping the term "value in use"; distinguished between measure and cause rather clearly; and gave several good illustrations of the way in which the Classicists really took utility into consideration, though without elaborating the point (e.g., *Political Economy,* p. 51). His recognition of the difference between the "intensities" of demand and supply, and the quantities of goods demanded and supplied, is also of interest.

He follows Smith in retaining the distinction between productive and unproductive labor, but does it intelligently and with due definition. His discussion shows clearly the semi-ethical teleology of the Classical economics.[2]

In addition to the weakness of his position on the subject of overproduction, the necessity for modifying Malthus' conclusion as to the peculiar power of an agricultural surplus to create a demand and raise up a population, is not to be overlooked. Certainly the products of manufactures may be thought of as creating a demand in just the same way as those of agriculture. In this respect, a difference in degree may exist between the "machine," land, and other machines; but there is none in kind, save that which may arise from the less elasticity of the demand for food. In a similar way, Malthus' optimistic notion of the source of rent is one-sided, and, as will be seen, Ricardo took the other side.

The Philosophy of Malthusianism. — The Malthusian principle of population tended to introduce or maintain the idea of a balance or equilibrium between opposing forces, making economic life largely a struggle between "man" and "nature." This suggests two independent realities, and a dualistic philosophy.

As a matter of fact, however, a thinker may tend to regard man as a passive element, or as being subject to blind unreasoning instincts. In that event, he becomes a materialist. Or he may tend to regard man as taking thought about the problem of population and as solving it, either by "conquering nature" or by mastering his own instincts. In this event, he leans toward idealism.

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[1] *Political Economy,* 2d ed., Preface, and pp. 98 f.

[2] *Ibid.,* pp. 34 ff.

As a man, Malthus had strongly idealistic leanings. By two influences, however, he was led to accept and emphasize the importance of material factors. First, he reacted against the extremes of idealism found in the thought of such men as Godwin. Second, his reason was affected by the predominately materialistic thought of the scientists of his day. Accordingly the principle of population as actually formulated by Malthus, was based upon a materialistic philosophy. Man is regarded as largely subject to (1) instincts and organic wants, and to (2) the limitations of natural environment. Furthermore, man himself is not perfectible, and government action can be relied upon to but a very limited extent. When Malthus says that he can judge the future only by the past, he implies a materialistic epistemology, and a belief in limited powers to plan and to control economic life.

A thinker such as Malthus, however, would be bound to react from the extremes of materialism, and this is what he was doing in his later editions. More and more, he dwelt upon man's power of self-control through "moral restraint," and expressed hopes that educational processes might aid reason in solving the population problem.

The upshot of the matter is that Malthus developed and made effective a strain of thought which tended strongly to maintain a dualistic philosophy as the background for Classical economics. The immediate effect was to accentuate the materialist tendencies, but also to challenge economists to devise reforms. The outstanding and continuing practical result has been to check any tendency toward extreme idealism.

Critical Estimate of the Malthusian Doctrine. — Despite the criticism and derogatory estimate of his contemporaries and followers, Malthus' claim to importance as an original thinker is supported by most of the best present-day thought.[1]

But his errors are not few. Taking his most careful statements of the three factors in his problem *separately*, and considering them as applying to mere *tendencies*, in the sense that they would be true if not interfered with, they stand. Malthus, however, sometimes puts his "powers" and "tendencies" together, and so states them that their character as mere potentialities is lost. Thus with the tendency of population to increase. The undoubted strain of pessimism his work holds, leads him to underrate the future development of education and prudence. The power to check population which a standard of living above subsistence may exert, is overlooked. Putting the ideas of checks and rate of increase together, and easily falling into too positive statement, the limitations and abstractions are forgotten. He knew what had happened; he saw what was happening; but, influenced by his surroundings, his vision as to what was to happen, was unduly obscured.

It is difficult to determine to what extent this indicates a serious limitation of his powers, and consequently is an adverse criticism. It would appear most just simply to hold that, lacking later data, he was not in as good a position as are we to judge of the efficiency of moral restraint.

It has been suggested, too, that Malthus failed to distinguish between the desire for offspring, on the one hand, and that for sexual gratification, on the other. If the "passion between the sexes" to which he refers should solely or chiefly concern the latter desire, it might remain virtually unchecked without increase in population. It might be considered as a given quantity without fearing overpopulation. This is evidenced by the low birth rate, small average family, and almost stationary population of France today. It must not be forgotten, however, that the application of this criticism may vary accordingly as we define the term "vice" under the preventive checks. Malthus' definition of "vice" was a broad one, and would largely cover the case suggested in this criticism. Indeed, he specifically states that "if we consider only the general term [preventive check] which implies principally a delay of the marriage union from prudential considerations, without reference to [moral] consequences, it may be considered in this light as the most powerful of the checks, which in modern Europe keep down the population to the level of the means of subsistence." [1]

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[1] Those inclined to belittle are Oppenheim, Ingram, and Cannan, for instance, while, on the other hand, Cossa, Marshall, Taussig, Ely, Patten, Carver, Bonar, Price, Cohn, and Wolff (J.) are among those attaching great importance to his thought.

Again, though this is not essential to his thesis, he has been criticized for a lack of breadth and foresight in his view of the possibilities of increased subsistence through improvements in agricultural science and transport. Some have gone so far as to claim that progress in agricultural technique offsets the increase of population. But such would-be critics are apt to overlook the fact that while output per acre may increase, the cost may increase at a greater rate and consequently the output per unit of cost decrease.

They are also given to pointing to the large population which now enjoys a better subsistence than ever before, as evidence of a breakdown in the Malthusian principle, not noticing that it has been the opening up of new sources of subsistence by improved transport methods that has made this fortunate situation possible, — a condition which not only does not disprove the "tendencies" formulated by Malthus, but which cannot continue indefinitely. Moreover, it is easy to overlook the fact that he recognized that subsistence might increase indefinitely, and that his argument had as its essential merely a *different rate* of increase as compared with population. On this particular point, if more attention had been given to his ratio, and less to his separate rates, there would have been less misunderstanding.

Finally, when he puts his rates of increase in population and produce together, the fact that his idea of diminishing returns was limited, appears. ✓Increased density of population has often acted to reduce costs and increase production by causing better division of labor and improvement in transport and organization of markets. These things, however, are after all but evidences of the "pressure of population" compelling steps to secure relief: population and productive organization may each react upon the other, but population, "when unchecked," is the steady driving force. Certain it is that, whatever the organization or improvement, there must ultimately be some new space available for occupation by any steadily increasing population. Malthus' idea, therefore, appears to be substantially correct. The trouble, as one writer has felicitously expressed it, is that "he does not lay stress, at any rate with sufficient explicitness, on the limiting conditions of its application to fact." [1] He does not appreciate to the full the possible effects of an increase in population in maintaining or swelling the rate of increase in subsistence.

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[1] 5th ed., II, 218.

In these matters, Malthus made too much of not being able to judge of the future except by the past.[2] There is a sense in which this inability exists, but such an attitude may lead to undue narrowness of view. In a word, to the extent that Malthus gave ground for thinking the law of diminishing returns an historical one, he was wrong. This is true, *on the whole,* of his first edition, alone. In the later ones, he lapses into similar statements, but more and more guards himself.

It may truly be said that it is by taking the Malthusian theory as a whole, and considering population in relation to subsistence, that a true estimate of it is to be gained. Accordingly, when all has been said, the truest weakness of the theory lies in its omissions concerning the possibility of adjustments in the ideas of man with relation to subsistence.[3] (1) "Subsistence" is a relative thing, and means different quantities and qualities according to differences in "standards of living."

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[1] Price, *Political Economy in England,* p. 49.

[2] See, e.g., Appendix to 3d ed.

[3] Note the materialism involved, and the fallacy.

(2) Population may be checked by causes not connected with subsistence, or not proportional to it. Malthus recognized this fact, but treated it as a mere "exception." He admitted, for example, that an increase in subsistence, if it came to the well-to-do classes, might not cause increased population. But if this is true, how softened and contingent becomes his "principle of population"! Such an admission almost turns the "principle" around and makes population depend upon poverty — a part of population is poor; therefore, a part of population tends to multiply faster than subsistence!

Undoubtedly some of the shortcomings of Malthus' logic are to be condoned as being due to his effort to attain a concise and forcible statement, which may be considered a factor in the misunderstanding of his doctrine.

Malthus' Contributions. — As one of the most important of Malthus' services, the fact is to be mentioned that he was the first to devote a treatise to the principle of population. Thus he deserves great consideration for calling attention to the economic significance of an important subject which had been neglected. He gave the problem a definiteness and distinctness which made its significance tangible.

The Malthusian theory is important from the fact that it was partly instrumental in leading Darwin to his doctrine of Natural Selection. Darwin himself has said that his theory of the struggle for existence was only "the doctrine of Malthus applied with manifold force to the whole animal kingdom." Furthermore, Malthus collected a mass of valuable facts illustrative of his doctrine. These were important as showing the effects of various checks and stimuli, — emigration, poor laws, various customs. They influenced legislation, on the one hand, and on the other, they give him a claim to a place among the founders of historical economics.[1]

In this connection, it should be remembered that Malthus introduced a dynamic factor into economics. His principle of population made it more difficult to make the dangerous assumption, "other things being equal," or to proceed abstractly on the basis of "given conditions."

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[1] Marshall, *Principles of Economics*, 4th ed., p. 256, note.

The Malthusian theory is especially essential to an understanding of the problems of social reform. Thus John Stuart Mill was prevented from unreservedly advocating governmental interference with wages, of a highly Socialistic character, chiefly by his belief in the theory of population which Malthus taught.

If the difficulties Malthus saw are real, they must be reckoned with. If they are not, and the Malthusian doctrine is to be rejected, some other theory must be produced which will better explain the facts upon which Malthus based his reasoning, and which others have confirmed. The economist cannot go far without recognizing the tendencies with which Malthus dealt; and those attempts to solve the social problem which run counter to the principle of population must ultimately fail.

In conclusion, we cannot forget that Malthus has a claim to recognition as one of the co-discoverers of the relationship between diminishing returns and land rent.[1]

BIBLIOGRAPHICAL NOTE ON EARLY ENGLISH CONTROVERSIES CONCERNING THE POPULATION QUESTION (1803-1833)

Malthus' essay provoked much discussion, and numerous works were put forth attacking his thesis, while others rallied to its defense. There were "anti-populationists" or "subsistencians" (followers of Malthus), and "populationists" (his opponents). Some of the books of the day were as follows: —

1806: Jarrold (T.), *Dissertations on Man, Philosophical, Physiological, and Political; in answer to Mr. Malthus's "Essay on the Principle of Population."* The thought is optimistic, upholding Godwin, and proceeding from theological premises. Malthus' checks are held to "arise out of circumstances that are perfectly optional, and are most experienced under a bad system of government" (p. 361). The most interesting point is his idea that anxiety and care lead to the extinction of those affected.

1807: Hazlitt (Wm.), *A Reply to the Essay on Population in a Series of Letters.* Published anonymously. This work argued that there is no limit to subsistence until the earth's surface shall be occupied and intensive culture resorted to.

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[1] See below, p. 293.

1815: Gray, *Happiness of States.* "In all ordinary circumstances population has a tendency to increase, but not to over-increase; for this increase carries in itself the power of fully supplying its various wants." Population regulates subsistence.

1816: Weyland (John), *The Principles of Population and Production, as they are affected by the Progress of Society; with a view to moral and political consequences.* Argues from theological premises, the Malthusian principle running counter to the idea of a benevolent creator (p. 6). The natural tendency of population varies with the state of society. Naturally, it tends to keep within the limits set by the powers of the soil, only exceeding them through impolitic laws and customs. Some measure of excess is beneficial, as it stimulates progress.

1816: Grahame (James), *An Inquiry into the Principle of Population, including an exposition of the causes and the advantages of a tendency to exuberance of numbers in society.*

1818: Purves (G.), *The Principles of Population and Production investigated; and the Questions does Population regulate Subsistence, or Subsistence Population . . . discussed.* "Purves" was a *nom de plume* adopted by Gray, who published a book in 1815. "The notion of a *constant tendency in subsistence to increase less rapidly than population, and consequently to check the latter by scarcity,* is a wild fancy, utterly unknown to nature, and in as direct opposition to the results of her arrangements, as any such tendency in clothing, building, or any other division of the supply" (p. 68). Scantiness of subsistence tends to increase births, superfluity to diminish them. Abundance of untouched means existing in old countries refutes Malthus. Population has no natural ratio of increase, when compared with time; while the ratio of increase of subsistence is impressed upon it by the cultivator.

1818: Ensor (George), *An Inquiry concerning the Population of Nations, containing a refutation of Mr. Malthus's Essay on Population.* Advocates political reforms as the remedy.

1820: Godwin (Wm.), *Essay on Population.* Contains an essay by Booth on Malthus' ratios, which purports to refute Malthus' use of ratios of increase. Malthus' American statistics are criticized. Godwin argued that history shows population has not decreased in many states; and that in Sweden, where conditions are favorable, population doubles but once in 100 years. Each new improvement makes a new start by placing population and subsistence rates on a new level of equality. Any excess of population comes in the shape of infants, which serves as a warning and enables adaptation. Moreover, each man has within him the power to produce more than enough for his subsistence. He lays any suffering due to overpopulation at the door of political facts.

1821: Ravenstone (P.), *A Few Doubts as to the Correctness of Some Opinions Generally Entertained on the Subjects of Population and Political Economy.* The tendency of population to increase is nearly equal in all times and places, and is not so rapid as Malthus thinks. No restrictive measures are needed, for subsistence depends upon numbers. In arguing that rates of increase are independent of social institutions he also undertakes to refute Godwin's arguments.

1822: Place (Francis), *Illustrations and Proofs of the Principle of Population: including an examination of the proposed remedies of Mr. Malthus, and a reply to the objections of Mr. Godwin and others.* Through a study of immigration to America Malthus' conclusions as to the rate of increase in population in that country are substantiated. Place himself emphasizes education as a remedy.

1823: Everett (A. H.), *New Ideas on Population.* Increase in population brings its own remedy in increased productivity through division of labor and increased skill.

1830: Sadler (Michael T.), *The Law of Population; a Treatise in Six Books; in disproof of the superfecundity of human beings, and developing the real principle of their increase.* Attempts *a refutation of Malthus by statistics.* Theological premises. His "law" was that prolificness varies inversely with numbers, the controlling force being space, modified by the character of the land.

1831: Senior (Wm. N.), *Two Lectures on Population* (Oxford). Senior upholds Malthus. He emphasizes security, freedom of internal and external trade, equal social and industrial opportunity, and education. "These are propositions which Mr. Malthus has established by facts and reasonings, which, opposed as they were to long-rooted prejudices, and assailed by every species of sophistry and clamour, are now so generally admitted, that they have become rather matters of allusion than of formal statement" (p. 50). Senior appends letters from Malthus explaining that by "tendency" he does not necessarily mean an actuality.

1832: Anonymous, *An Enquiry into the Principles of Population, exhibiting a system of regulations for the Poor, designed immediately to lessen and finally to remove the evils which have hitherto pressed upon the Labouring classes in Society.* Better adjustment of labor needed. Possibilities of chemistry in producing subsistence noted.

1832: Owen (Robt. D.), *Moral Physiology, A Brief and Plain Treatise on the Population Question.* "Neo-Malthusian" — artificial restriction of size of families.
1833: Lloyd (W. F.), *Two lectures on the checks to population.*

For Carey's criticism see below, p. 324. For those of Sismondi and Messedaglia, see pp. 398, 678. The discussion was also carried on in other countries. Most of the criticism of Malthus was either beside the point, because his critics did not understand his principle with its several limitations and qualifications, or was vitiated by irrational theological premises.

CHAPTER XIII

RICARDO AND THE THEORY OF DISTRIBUTION, ESPECIALLY THE RENT DOCTRINE[1]

Life and Circumstances; Chief Writings. — David Ricardo was born in 1772, in England. His father, who was an immigrant from Holland, was then a member of the London Stock Exchange. His ancestors came from Portugal, a remarkable branch of a remarkable group. Spinoza, the philosopher, and Isaac Pinto, a publicist, came from the same stock. The boy received some commercial education, and at fourteen began his acquaintance with the Exchange.

Becoming involved in religious difficulties, he finally changed his creed and was cast off by his father. At twenty-one he began business on his own account, became a member of the Stock Exchange, and at twenty-five had already acquired a fortune. Coolness, good judgment, surprising quickness at figures and calculation, and a great capacity for work, were factors in his success.

Having acquired a competence, Ricardo began to interest himself in science. He first took up mathematics, chemistry, and geology; but, in 1799, his attention having been drawn to economic studies by a perusal of the *Wealth of Nations*, he came to devote himself chiefly to political economy.

His first publication was a tract entitled *The High Price of Bullion a Proof of the Depreciation of Bank Notes.* Appearing early in 1810, it passed through four editions in two years, and its principles were adopted in the Report of the Bullion Committee. When Mr. Bosanquet, a prominent merchant, criticized these principles, Ricardo was induced, in 1811, to write a *Reply to Mr. Bosanquet's Practical Observations on the Report of the Bullion Committee.* This reply is called by M'Culloch "one of the best essays that have appeared on any disputed question of political economy." It was followed by two tracts or essays: *Essay on the Influence of a Low Price of Corn on the Profits of Stock* (1815), and *Proposals for an Economical and Secure Currency* (1816).

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[1] On Ricardo and his work, cf. Patten, "Malthus and Ricardo," *American Economic Assoc. Publications*, 1889; Hollander, "Development of Ricardo's Theory of Value," *Quart. Jr. Econ.*, 1904; *American Economic Association Papers*, 1911 (Proceedings of Annual Meeting, St. Louis, 1910); Diehl, *David Ricardo's Grundsätze der Volkswirtschaft und Besteuerung*, Leipzig, 1905; Hollander, *David Ricardo*, Johns Hopkins University Studies, 1910, and the following footnote references.

In 1817 he published his chief work, *On the Principles of Political Economy and Taxation.* Although the book marked the beginning of a real epoch in economic thought, only with great reluctance and after considerable persuasion on the part of his friends did Ricardo consent to bring it before the public. He had already acquired some reputation, and it has been said that he feared this work would not sustain it. If such were his feelings, he was most happily disappointed. A second edition appeared in 1819, and a third in 1821.

His other important economic publications were "The Funding System," an article contributed to the *Encyclopædia Britannica* in 1820, and a pamphlet on *Protection to Agriculture.* The latter appeared in 1822, and is called by M'Culloch, who was, of course, a warm admirer, "the best of all his pamphlets and indeed a 'chef-d'œuvre.'" M'Culloch adds, "Had Mr. Ricardo never written anything else, this pamphlet would have placed him in the first rank of political economists."

A manuscript describing a *Plan for the Establishment of a National Bank* was published after Ricardo's death, which occurred in 1823.

Ricardo was for some time a member of the House of Commons, to which he was elected in 1819, to represent Portarlington. He was an independent in politics, but was generally found on the side of progress and reform. He did not, however, take as active a part in Parliament as might have been expected. He never spoke upon any subject to which he had not given long and careful study, and was regarded as an authority by many, his opinions being highly valued. Lord Brougham describes him as a speaker who was persuasive on account of the apparent sincerity and purity of his motives, and by reason of the clearness and force of his arguments.

In his private relations, he was kind and charitable, and made a generous use of his wealth. Besides responding largely to appeals made in behalf of other institutions, he supported entirely out of his own pocket two schools and an almshouse.

Some of the differences between the industrial environment of Adam Smith and that of his followers have been touched upon in the chapter on Malthus. There, the growth of population and attendant poverty were noted. In connection with Ricardo and his time, it is particularly noteworthy that there had come a completer working out of the results of the Industrial Revolution, and the establishment of the factory system. There was also a rise in grain prices, caused by currency depreciation, increased urban population and other circumstances. This was accompanied by a resort to poorer soils, and higher rents.

The first development meant a more capitalistic industry in every sense; that is, a larger use of fixed capital in the form of plant and machinery, and also an increased scope and significance of property rights, individual business enterprise, and competition. Old restrictions and regulations became obsolete and began to be repealed, and for a time competition was given nearly full sway. Old labor laws were repealed, and the trade-union problem grew apace. The rise of new industries, the expansion of trade, and the Napoleonic wars, begot change and mobility which were notable in contrast with the past.

At the same time, rising prices for food brought on "corn law" discussions, and the manufacturing classes, desiring cheap food for cheap labor, were arrayed against the landowners.

In such an atmosphere, the question of the distribution of wealth could hardly sleep. What was the cause and what the remedy for high food prices and rents? How should wages be determined, and what would be the effect of labor organization? Upon what class should taxes rest? How would all these questions affect the profits of the capitalist class? Such were the problems of the day. The economist can see now that the time was pregnant with a theory of distribution, which, assuming competition, would center round the margin of land cultivation. In the hands of a thinker like Ricardo, a Jew and a man of the Stock Exchange, such a theory would be given an abstract and absolute setting.

The *Principles of Political Economy*. — a. *Value.* — In the first line of his first chapter, Ricardo quotes Adam Smith, and proceeds to follow him in distinguishing "value in use" from "value in exchange." The latter is the value with which political economy is concerned. Utility is not the measure (determinant) of "exchangeable" value, though it is "absolutely essential to it." "Natural value" is distinguished from that of the market, being not temporary and fluctuating, as the latter, but that which would exist if there were no disturbance in market conditions. It is always of this "natural" or normal value that Ricardo speaks. Thus far, then, Ricardo follows Smith.

Assuming their utility,[1] he next divides commodities which have an exchange value into two classes: those which derive it from scarcity, and those which derive it from the quantity of labor required to obtain them. A picture by Raphael would belong to the first class. Its value would be altogether irrespective of the labor it had cost, and would depend only upon what people could or would give. This class of commodities is, however, so limited in extent that Ricardo leaves it out of consideration, and devotes his attention to commodities of the second class: those which are "procured by labour" and which may be multiplied according to desire "without any assignable limit."

Adam Smith had explained that in the early stages of society preceding the appropriation of land and accumulation of capital, the relative values of such things depended upon the quantities of labor expended in procuring them. In this, Ricardo agrees with Smith, but differs in maintaining that even after land has been appropriated and capital applied to industry,[1] relative values depend upon the quantities of labor required, the same as before. Smith thought that in our present social organization, other elements than labor affect the comparative value of commodities; he found it influenced by wages, profits, and rent. But Ricardo maintained that the rates of wages, profits, and rent exercise no influence on normal relative or exchange values. Profits and wages are equalized in all industries, Ricardo held, and hence could not affect relative values; while rent is a result, not a cause, of values.

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[1] Ricardo said utility is "absolutely essential," but saw in it no means of measuring or determining values. To him, an analysis of sellers' costs was most important. He had no distinct concept of marginal utility.

Regardless of the truth or error of this position as a positive contribution, it was undoubtedly an important clarification of Smith's position. M'Culloch even claimed that to have demonstrated that the quantity of labor required to produce a good is not identical with the quantity of labor for which the good will exchange, and that the former quantity is the true basis of value, was one of the greatest improvements made in the science.[2]

The argument runs as follows: Wage rates do not affect general relative values, because they, like profits, are the same in different employments. Perfect competition is assumed, with the corollary that the same price is paid for the same kind of labor by all employers. So long as A and B pay the same sum for a day's work of the same kind, it is manifestly indifferent whether the sum be $1 or $10: both are affected alike by the rate of wages.

But if I offer to exchange with you a commodity on which five days' labor has been expended for one which required ten days' labor, you will object that the commodity I offer is worth only half yours, because it cost but half the labor. Difference in *quantity of labor*, then, causes difference in value — if we assume equal wage rates.

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[1] Indeed, Ricardo taught that capital of some sort had coöperated with labor from earliest times.

[2] *Principles*, part 3, § 1.

In this conclusion Ricardo takes some account of different qualities of labor; but argues with much obscurity that "the estimation in which different qualities of labour are held comes soon to be adjusted in the market," while, in case the same commodity is concerned, he assumes that variations in quality of labor between different times may be disregarded, — a questionable assumption.[1] This much can be said: Ricardo recognized that in comparing quantities of labor time, allowance must be made for difference in intensity and skill. His mistake lies in the extreme and impractical abstractness of an assumption of equality of labor,[2] a mistake which was later to be made the basis for a theory of value by the Socialists.

What has been said of labor in general, applies equally to the labor employed in the production of capital. That is, capital is apparently reduced to stored-up labor. The "exchangeable" value of commodities in modern society, then, is in proportion to the labor spent not only on their immediate production, "but on all those implements or machines required to give effect to the particular labour to which they were applied." Apparently, the idea is that as the capital is used up in production it gives off the labor which it embodies.

It might thus seem that Ricardo, taking a step which Smith's common sense had shunned, and following along the road indicated notably by certain Mercantilists,[3] had adopted a pure labor-cost theory of value. Such was doubtless his tendency. He was compelled, however, to introduce several modifications, and finally to abandon this theory in its purity.

While reducing capital goods to terms of labor, Ricardo reaches the conclusion that *difference in durability of capital may also allow value changes*, quantities of labor being equal.

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[1] Cf. Whitaker, *Labor Theory of Value*, Columbia University Studies, XIX, No. 2, pp. 47 f.

[2] See Jevons' criticism, *Theory of Political Economy* (1871), p. 160. Cf. the criticism of Marx, below, pp. 492–494.

[3] See above, p. 131.

Such differences, by introducing a varying time element, make it possible for changes in wages and profits to affect costs in different industries unequally, and therefore to affect relative values. The less durable fixed capital approaches the nature of circulating capital. Evidently, if other things be equal, but if the capital of one producer be less durable (fixed) than that of another producer, it will be used up more rapidly; and this difference alone will cause a difference in the cost and the value of their products. If, however, a machine is very durable, the value of its product will be less affected by changes in wages and profits than one which soon has to be replaced.[1]

While the mere introduction of capital does not affect relative values, according to Ricardo the existence of differences in the proportion of fixed and circulating capital in different industries does affect relative values, and thus modifies his labor-cost theory.[2]

In a word, in treating of the results of the introduction of machinery, etc., even though regarding it as "canned" or "petrified" labor, Ricardo admits that his assumption of equalized wages and profits breaks down, and with it goes the argument against the entrance of wages and profit into values.

Finally, in a note to the third edition of his *Principles*, page 46, he virtually admits that profits — that is, interest — is a cost of production. And in various letters to economist friends, he shows the same admission in more or less explicit form. To Malthus, who combated his theory, he confessed that it was not strictly accurate, but maintained that so far as he could see it came nearest the truth, as a *measure* of exchange value; while he wrote to M'Culloch, who believed as he did, that he often thought that were he to rewrite his chapter on value he would admit two factors: the quantity of labor, and the rate of profit which existed during the round of production.

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[1] Chap. I, § 5. For a good discussion of this matter see Whitaker, *History and Criticism of the Labor Theory of Value*, Columbia University Studies, XIX, No. 2, pp. 52–56.

[2] Chap. I, § 3. A rise in the wage rate would bring a fall in the interest rate. At the lower interest rate, fixed capital represents the present value of a smaller annuity, or annual return. Fixed capital, then, could be replaced more cheaply. Under perfect competition the value of its product falls, and the more fixed capital in proportion to circulating, the greater the fall.

Ricardo seems to have thought an unvarying standard or measure of value very desirable, but deemed it impossible; for he believed that there is no commodity which requires an unchanging quantity of labor for its production. If there were, differences in the periods for which capitals are advanced would invalidate it. But he found so little change in gold and silver that he took money to be stable enough in its value for ordinary purposes. Toward the end of his career, he more and more argued for the substantial validity of such a standard.[1]

Considering all modifications and utterances in his correspondence, the most just way to put Ricardo's doctrine, then, is as follows: assuming perfect competition, and considering only those commodities which can be indefinitely increased, the quantity of labor involved makes the only practical basis for comparing normal values. The idea of mere labor quantity, however, is somehow to be modified by recognizing the qualitative element, skill and intensity being considered. While normal value does not equal labor cost, the entrepreneur's expenses are substantially proportionate to the quantity of labor he uses. The payment of interest of different rates causes a variation which may be ignored for practical purposes. He had great misgivings concerning his value theory;[2] but retained it in his book to the end.

b. *Value and Riches.* — While he made the phenomena of exchange value the chief object of his study, Ricardo was far from being blind to the difference between "wealth" and "welfare." Indeed, how could he have been, familiar as he was with the work of Lauderdale? No one has more clearly expressed the difference or even conflict between the individual and social points of view with regard to the production and distribution of wealth than has the father of the Classical School's theory of distribution, and one should not claim to know Ricardo until one has read Chapter XX of the *Principles*, in which "value and riches" are discussed. There he states that value differs essentially from riches, in that it depends upon the difficulty of production, not upon abundance. By increasing the ease of production, we decrease values, but add to the "national riches" and to the power of future production. In close connection with a reference to Lord Lauderdale, he wrote the following paragraph: —

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[1] Hollander, "Development of Ricardo's Theory of Value," *Quart. Jr. Econ.*, XVIII.

[2] *Letters of Ricardo to M'Culloch* p. 132.

> "It is true, that the man in possession of a scarce commodity is richer, if by means of it he can command more of the necessaries and enjoyments of human life; but as the general stock out of which each man's riches are drawn, is diminished in quantity, by all that any individual takes from it, other men's shares must necessarily be reduced in proportion as this favored individual is able to appropriate a greater quantity to himself."

Ricardo expressly refers to this distinction as one, the failure to recognize which has been the source of many errors in Political Economy.

c. *Distribution.* — Probably, Ricardo's chief significance in the development of economic theory lies in his emphasis on "distribution," and in the progress he made toward bringing the theory of distribution into relation with the theory of value. The Physiocrats hardly conceived of distribution as a process of valuation that embraces all goods and services, including the factors of production. Adam Smith took a long step toward this conception; but his theory of value was not clear-cut, and he did not arrive at any marginal and differential analysis. Accordingly, one can piece together Smith's theory of distribution only with difficulty, and without consistency or completeness. With Ricardo, we for the first time come to grips with "the problem of distribution" in the sense of a comprehensive scientific attempt to deal with the causes that determine the "shares" in the total income of a society which go to the functional groups or classes. Such an attempt must correlate the values of products with the incomes of producers. Whatever the theory, the process of distribution must be explained, and that in a way to throw light upon both the value of the things distributed and the relative importance of the services performed by labor, land, capital, and enterprise. Something of this, Ricardo accomplished, although he did not succeed in avoiding circular reasoning, and throughout was handicapped by a one-sided emphasis of cost. He extended the application of "the price system" far into the field of distribution, and the Ricardian theory of distribution became the focus of economic theory.

The whole Ricardian scheme of distribution is put in a nutshell in his own words, thus: "Profits depend on high or low wages, wages on the price of necessaries, and the price of necessaries chiefly on the price of food." [1] The exchange value of food depends on the labor cost of producing it *at the margin* of land utilization; in the long run, wages tend toward a minimum set by this exchange value of food, and wage rates are equalized by competition. Profits get the remainder of the marginal product, and rates of profits are equalized by competition. In the more productive land uses, therefore, rent arises. Thus is the total product of industry distributed.

How then are the various shares determined?

d. *Rent.* — Ricardo's whole theory of distribution, including value, was inseparably bound up with the land factor and its margin of cultivation. He was not the first to have some idea of rent as a differential return. He was not the first to have some understanding of diminishing returns! But he was the first to bring these things into relation with his economic theory as a whole, and in the Ricardian economics the land margin occupies the center of the stage.

The Ricardian law of rent embraces two ideas or complementary phases: a resort to inferior soils and an extensive margin; and a law of diminishing returns leading to an intensive margin.

James Anderson, long reputed the originator of the rent theory, had at most grasped but one phase, the extensive margin; as late as 1801 he seems to have believed that increasing returns reward more intensive culture of lands already in use.[1] And in the first edition of his *Essay on Population* (1798) Malthus made no statement of a law of diminishing returns. It was one of the fundamentals of his theory, however, and in the second edition it appears clearly.[2] But it was not combined with the other phase to make a rent theory. Some trace of such a development, indeed, appears in his *Observations on the Effects of the Corn Laws* (1814),[3] but it was not until the middle of this year that the celebrated Parliamentary *Reports respecting Grain and the Corn Laws* were published, clearly pointing to a relation between rising grain prices and lower margins of cultivation, both intensive and extensive.

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[1] *Principles*, Chap. VI, p. 123, 2d ed.

A few months later, and almost at the same time, three men took the step of clearly coördinating the two margins:[4] Malthus in an *Inquiry into the Nature and Progress of Rent,* and *Grounds of an Opinion on the Policy of Restricting the Importation of Foreign Corn;* Sir Edward West in an *Essay on the Application of Capital to Land;* and Ricardo in his *Essay on the Influence of a Low Price of Corn.* Though his *Essay* was the last, Ricardo had suggested the step in a letter to Malthus;[5] and he so made the idea his own that there is a large element of truth in the phrase "Ricardian law of rent." In his *Principles* the full theory appears.

[1] See *Recreations in Agriculture, Natural History, etc.*, Vol. IV, p. 374. Cited by Cannan, *Production and Distribution*, p. 145. See Hollander, "The Concept of Marginal Rent," *Quart. Jr. Econ.*, IX, 179. On Anderson see Brentano (L.), *James Anderson: Drei Schriften uber Korngesetze u. Grundrente*, Leipzig, 1893. Anderson takes a series, A, B, C, D, E, F, representing different grades of land. Price determines rent. If price drops below cost on F, that land is abandoned, assuming society can get enough without it. Rent is the premium on cultivating superior soils. (*Inquiry into the Nature of the Corn Laws*, 1777.)

[2] Above, p. 267.

[3] Hollander, "The Concept of Marginal Rent," *Quart. Jr. Econ.*, IX, 180.

[4] Colonel Robert Torrens should be mentioned here. His *An Essay on the External Corn Trade* appeared early in 1815, stating the law of rent, in so far as an extensive margin is concerned, very clearly and quite independently of Malthus or West. Perhaps John Rooke was the first to suggest the rent doctrine. Though his *Principles of National Wealth* did not appear till 1825, the suggestion of the theory appeared in a series of articles in *The Farmer's Journal* during 1814 and 1815, especially February, 1815. (See Seligman, "Some Neglected British Economists," *Econ. Jr.*, XIII, 511 f.)

[5] Letters of Ricardo to Malthus, ed. by Bonar, p. 47. Oct. 23, 1814.

Adam Smith and the Physiocrats, as has been seen, regarded rent as a gift of nature, and as consisting in that part of the produce of land which, after deducting the wages of labor and profits of capital, is received by the landlord. They, however, did not attempt to determine precisely what rent different landlords would receive. Ricardo was in a position to develop their ideas on this subject. Rent he defines as "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil." It "invariably proceeds from the employment of an additional quantity of labour with a proportionally less return." [1]

Accordingly, the portion of the landlord may be discovered by considering the successive steps by which the land of a country is brought under cultivation. So long as the best land is abundant and every one can have it by taking possession, it is manifest that there can be no such thing as rent. As population grows and the needs of the people become greater, however, the best land is gradually taken up until none remains. It is now necessary to have recourse to land of an inferior quality, which may be called land of the second class. Now those who have already taken possession of land of the first class have a manifest advantage over those who are obliged to take up land of the second class. Land of the second class must pay the wages of labor and the ordinary profits of capital, or it would not be cultivated. But land of the first class does this and something more. This something more constitutes the rent of the landlord: the farmer can give him so much and still receive the usual rate of profits and pay the wages of his labor.

In the course of time, it becomes necessary to cultivate land of a still poorer quality, land of the third class. As profits on capital must be equal as well as wages, according to Ricardo, and as this poorer quality of land must pay profits and wages, land of the second class can pay a rent which is equal to the difference between the value of its produce and that of the poorest land under cultivation. Land of the first class pays a higher rent, equal also to the difference between the value of its produce and that of land of the third class.

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[1] *Principles*, Chap. II, 2d ed., pp. 47, 55.

This leads to the following conclusion: "With every step in the progress of population, which shall oblige a country to have recourse to land of a worse quality, to enable it to raise its supply of food, rent on all the more fertile land will rise," and will always be equal to the difference between the produce of a given quantity of capital and labor on the more fertile land and the poorest.

It often happens, however, that additional capital will be applied to land already in a state of cultivation instead of taking up new land, which event "will equally create a rent." Suppose that a given amount of capital and labor produces on the best land one hundred quarters of wheat, and that doubling the capital and labor would produce eighty-five additional quarters. The additional investment would be made in case land of the next lower quality would not produce eighty-five quarters if the same amount of capital and labor were applied to it. In this case, the landlord would receive the difference between the products of the two units of capital and labor invested, or fifteen quarters. "In this case, as well as in the other, the capital last employed pays no rent." [1]

It follows, of course, from the foregoing that rent, as such, has no direct effect on prices, for they are determined by cost of production on the land which pays no rent. If contract rent [2] were abolished, the cultivators of the more fertile soils would receive the income of the landlords, but no other class of society would receive any benefit by its abolition.

Toward the close of his chapter, Ricardo discusses the effect of improvements on rent, concluding that, inasmuch as they diminish inequality in the produce of portions or units of capital employed on land, they tend to reduce rents. Improvements, however, are of two sorts, and do not affect rent equally. Those which, like better fertilization, enable us to obtain the same produce from a smaller quantity of land, and so tend to raise the margin through a withdrawal of the worst land from cultivation, lower both corn and money rents. On the other hand, improvements in agricultural machinery, etc., may simply lead to the production of the same quantity on the same lands at a lower cost, thus reducing money rents, but leaving corn rents unaffected. If the latter improvement leads to a readjustment of investment, however, so that a larger proportion of a given capital is applied to the better land, both corn and money rents will be affected.

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[1] *Principles*, Chap. II, 2d ed., p. 54.

[2] It is conducive to clearness to keep the distinction between pure economic rent and contract rent in mind. The latter is the rent paid by a tenant to the landowner, and may be more or less than the economic rent. Contract rent can be abolished; but economic rent, existing in the nature of thought, must exist wherever there are investments on land which yield different returns per unit.

The landlord is benefited by difficulty of production. The farther down in the scale the increase of population forces cultivation, and the higher the price of provisions, the greater his gains. His advantage is thus opposed to that of the rest of society, — another view with a pessimistic tendency.[1]

Ricardo and Ricardians were erelong to have some aspects of their rent doctrine criticized[2] on the ground that they assumed an order of cultivation in which men took the most fertile lands first and proceeded to less and less fertile ones, which is not always the fact. But Ricardo's statement is this: "The most fertile, and most favourably situated land will be first cultivated." While the unwary reader may easily get the impression that fertility alone is considered, this is not the case. The situation element is recognized. If all lands were equally fertile, there would be no rent, "unless where it possessed peculiar advantages of situation," says Ricardo.

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[1] On the other hand, a certain note of optimism born of the possibility of increasing returns in manufactures may be noted. In Chap. V, "On Wages," he wrote: "The natural price of all commodities, excepting raw produce and labour, has a tendency to fall, in the progress of wealth and population;" for the rise in price of raw material is "more than counterbalanced by the improvements in machinery, and by the better division and distribution of labour, and by the increasing skill both in science and art, of the producers."

[2] By Carey in America (below, p. 322), Torrens in England, and von Thünen in Germany. The first was most sweeping; the two last merely emphasized the situation element. Samuel Read in his *Natural Grounds of Right to Vendible Property or Wealth* (1829) also criticized Ricardo.

In any case, of course, the criticism bears only upon the movement of rent as an historical fact, which is not the essence of the theory.

Assuming that the movement was from better to worse soils, — as, indeed, it is, *all* things considered, — Ricardo took the pessimistic view that rent is not the result of the generosity of nature, but of her niggardliness. If there were an unlimited supply of equally productive land, as there is of sunshine and water, there would be no rent. "Nothing is more common," says Ricardo, "than to hear the advantages which land possesses over every other source of useful produce, on account of the surplus which it yields in the form of rent. Yet when land is most abundant, when most productive and most fertile, it yields no rent, and it is only when its powers decay, and less is yielded in return for labour, that a share of the original produce of the more fertile portions is set apart for rent. It is singular that this quality in the land, which should have been noticed as an imperfection, compared with the natural agents by which manufactures are assisted, should have been pointed out as constituting its peculiar preëminence."

Malthus, starting with early society, when poor tools and often the less fertile soils were used, pointed out that then population was checked by scanty food. With civilization came improved processes and implements, increasing the produce. The tendency of population to outrun subsistence, however, keeps prices up, and therefore rent increases. Malthus does not consider it to be a deduction from other shares. It is the result of the bounty of nature.

Ricardo, on the other hand, takes the England of his day. He sees cultivation extended to poorer soils, and more intensive culture. At the same time, rents are increasing and profits decreasing. He concludes that rent is a deduction from the other shares in distribution, and is due to the niggardliness of nature.[1]

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[1] See Patten, *Malthus and Ricardo*, American Economic Association Publications, 1889.

In criticizing the Ricardian theory of rent, one must keep distinct the theory, as such, and any deductions about social classes and historical movements. Two men might uphold the theory while maintaining different views on the latter subjects, as did Malthus and Ricardo. The rent theory proper stands to this day, the result of nearly a century of criticism having been a more careful and limited formulation, and a less absolute statement of its unique character. (1) Thus the word "indestructible," as referring to the powers of the soil, has been dropped as being misleading. In so far as certain elements of fertility are concerned, the power of land may be destroyed and replaced in a sense somewhat similar to that in which things are "manufactured." [1] Yet there are certain elements that go with land, such as climate, which in the present state of the arts can neither be destroyed nor made; while, in general, the destruction and making of any land element takes place with such unequal facility as to make those relatively permanent inequalities which are essential to the rent theory. (2) That differentials similar to land rent are widespread, both in labor and capital payments, has been pointed out. These have been called "quasi-rents," but lack the permanence and generality of land rents. (3) Then there are those, beginning with Mill, who attack the idea that land rent is price determined, and maintain that under certain exceptional conditions, if considered from a narrow individual point of view, rent enters price. (4) Richard Jones, in an *Essay on the Distribution of Wealth*,[2] criticized Ricardians because at various times and places the principles laid down by Ricardo did not seem to apply in the case of peasants' rents. But again, this only shows that, competition being limited by custom, the full economic rent was not exacted. This may be true today, but does not affect the Ricardian theory proper.[3]

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[1] Yet even here the question may be raised if the difference in degree does not constitute a difference in kind, as so often happens in economics.

[2] London, 1831.

[3] For full discussion of various criticisms see Diehl, *Ricardo's Volkswirtschaft und Besteuerung* (Leipzig, 1905), Vol. II, pp. 199 ff.

e. *Wages.* — Rent being measured from the worst investment on land, where wages and profit alone are paid, Ricardo must next inquire what determines these payments. Following along the easy course indicated by the Physiocrats and Adam Smith, he adds the Malthusian principle, and the result is his so-called iron law of wages, *das eherne Lohngesetz*, as Lassalle called it. The theory was virtually formulated by Torrens in 1815.[1] It is this: "The natural price of labour is the price which is necessary to enable the labourers, one with another, to subsist and to perpetuate their race, without either increase or diminution." It was this natural or necessary price that chiefly concerned Ricardo.

Now labor, he would have said, is a commodity, and may be increased or diminished in quantity like other commodities. In an advancing state of society, the market price will be above the natural price and may continue so for a long time; but early and frequent marriages and large families will produce all the labor required, and will eventually reduce it to its natural price. In a declining state of society, on the other hand, labor would sink below its natural price, and the supply would diminish on account of frequent deaths, few marriages, and small families. This is substantially the view to be found in the writings of Turgot and Adam Smith, though the earlier thinkers did not formulate the law with the same precision.

But what forces make wages rise in an advancing state? What sets a maximum? What forces cause them to fall again? To just what level?

The market rate of wages, Ricardo thinks, may, in an improving society, be above the natural or normal rate for an

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[1] Ricardo was undoubtedly influenced in his statement by Torrens' *Essay on the Corn Trade*, which contains the following passage: "The proper way of regarding labour is as a commodity in the market. It therefore has . . . its market price and its natural price . . . its natural price . . . consists in such a quantity of the necessaries and comforts of life, as from the nature of the climate and the habits of the country are necessary to support the labourer, and to enable him to rear such a family as may preserve in the market an undiminished supply of labour" (p. 62). Ricardo himself says: "The whole of this subject is most ably illustrated by Colonel Torrens."

"indefinite period." This will be due to an increase in capital, by capital in this case meaning chiefly food and clothes; "for in proportion to the increase of capital will be the increase in the demand for labor." [1] Where there is an abundance of fertile land, the productive power of labor is high, and the accumulation of capital, which depends upon that power,[2] may be more rapid than the growth of population. Accordingly "the price of labor" rises.

But the increase of capital is limited by the productiveness of labor on land. As population increases, poorer investments on land must be made, and the return to capital being decreased, the demand for labor slackens. This brings the rise in wages to a halt. Ricardo sets no definite maximum point; save that in the chapter on profits he states that, at the margin, wages cannot rise so high as to deprive capital of all profit.[3]

"In the natural advance of society," however, wages have a tendency to fall. Real wages do so because demand decreases relatively to supply: population tends to increase, but there is a decreased rate of production on account of the limited quantity and differing quality of land. Thus more labor is required in production, and therefore the price of necessaries rises, so that money wages are sustained. Real wages fall, however, and the laborer is really worse paid. His fate is less happy than the landlord's; his corn wages will be reduced, and "his general condition will be deteriorated."

Here, then, is another view tending toward pessimism.

The minimum point is set by the quantity of food, necessaries, and conveniences which have become essential to the laborer through habit. This makes the natural wage. Thus, in Ricardo's wages system, the price of labor depends upon the price of those goods which the laborer's standard of living make essential, which price in its turn depends (chiefly) upon the quantity of labor required to produce the goods. In a word, the minimum daily wage, according to Ricardo, consists of the necessities which can be produced by the laborer in a day's work upon marginal land, the necessary profits upon the capital employed being deducted.

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[1] *Principles*, Chap. V, 2d ed., p. 89.

[2] *Ibid.*, p. 92.

[3] See below, pp. 304, 306.

It is hardly necessary to observe that this minimum is not the bare subsistence which it used to be painted. The "conveniences become essential to him from habit" may be considerably more than a bare subsistence. Ricardo makes this clear in discussing the variation of the natural price of labor in different countries.

In accordance with this idea of a minimum, Ricardo finds one means only of permanently assisting laborers, and that is by giving them such a taste for the comforts and conveniences of life as will lead them to regard the said comforts and conveniences as necessary to life. "The friends of humanity cannot but wish that in all countries the labouring classes should have a taste for comforts and enjoyments, and that they should be stimulated by all legal means in their exertions to procure them. There cannot be a better security against a superabundant population. In those countries, where the labouring classes have the fewest wants, and are contented with the cheapest food, the people are exposed to the greatest vicissitudes and miseries." [1]

As to government interference with the labor contract, Ricardo concluded that, "Like all other contracts, wages should be left to the fair and free competition of the market, and should never be controlled by the interference of the legislature." [2]

As indicated by the above exposition of Ricardo's theory, he at points clearly *suggested* a wages-fund theory. But he did not hold the idea of a rigidly fixed fund.[3] This, indeed would have been inconsistent with his idea of a natural wage determined at the poverty point. It was left for followers to develop the idea of capital as a fund for the subsistence of laborers and determining the demand for them.

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[1] *Principles*, Chap. V, 2d ed., p. 95.

[2] *Ibid.*, p. 103.

[3] See Taussig, *Wages and Capital*, Chap. IX.

So abstract and absolute a wage theory as Ricardo's proved thoroughly unsatisfactory. Nowhere does the viciousness of the great economist's abstract method appear more clearly. Overlooking differences in work and workers, non-competitive groups, etc., he assumes an average laborer doing average work under conditions of perfect competition, and receiving a "natural" wage. The effect of laws and customs is virtually ignored, or is dismissed as a "disturbing" factor. He assumes that all laborers are hired by capitalists with the idea of profit. In the face of facts, such assumptions appear so unreal as almost to make the so-called "tendencies" and "natural" wage rates deduced by their aid the exception rather than the rule.

Again, Ricardo made the Malthusian principle of population one of the factors in his wage theory. As stated by Malthus, the principle does not lead to a subsistence wage as a necessary conclusion, but as usual, Ricardo ordinarily leaves out "disturbing" elements! Even granting that Malthusianism does necessarily lead to this, it has appeared that as anything more than a statement of what would happen if certain other forces were not effective, the tendency of population to increase beyond subsistence is untrue. As more than a tendency — as an historical fact — it is not valid. Thus it is at best a weak argument upon which to base a wage theory. Ricardo's theory is as weak as is the Malthusian principle absolutely put without its limitations. Naturally, "it leads to as pessimistic conclusions."

f. *Profits and Interest.* — Ricardo's treatment on profits (interest) is the least satisfactory part of his work. It is not only accompanied by error, but is also so slighted and secondary as to be but a rudimentary theory. His whole treatment might with little exaggeration be styled "some remarks on the relation of profits to wages."

To begin with, there is scant discussion of the source of profits, and no analysis into component parts. Profits consists of interest and undertakers' or entrepreneurs' gain; but the two elements remain virtually undistinguished, Ricardo considering that the interest rate is determined by the rate of profit the entrepreneur can make. The source of profits, the productivity of capital, is taken for granted even more tacitly than the part played by utility in value.

The definition of capital comes in the chapter on wages. Capital is that part of a country's wealth which is employed in production, and consists of food, clothing, tools, raw materials, machinery, etc., necessary to give effect to labor. But chiefly, one gathers, it is considered as advances to laborers; and profits depend upon an excess of the product over such advances.

Briefly put, it is Ricardo's doctrine that the rate of profit depends immediately upon wages, rising as wages fall and falling as wages rise. Formally stated in his own words: "In all countries, and at all times, profits depend on the quantity of labour requisite to provide necessaries for the labourers,[1] on that land or with that capital which yields no rent." [2] For the determination of profits, we must look to the margin of cultivation. In the case of the least productive investment in agriculture, the total produce only pays labor and capital. There is no rent. This product, then, limits the amount of wages and profits. But how much of it will the capitalist get? He gets what the laborers leave. They must live and reproduce, and receive wages enough to enable them to do so, as well as obtain such conveniences of life as may have become necessary to them. The capitalist is the residual claimant.

If the marginal investment on land is yielding, say £720, it "must be divided between wages and profits. . . . If there be no excess, there will be no rent. Whether wages or profits rise or fall, it is this sum of £720 from which they must both be provided. On the one hand, profits can never rise so high as to absorb so much of this £720 that enough will not be left to furnish the labourers with absolute necessaries; on the other hand, wages can never rise so high as to leave no portion of this sum for profits." [3]

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[1] That is, on the value of labor, or wages.

[2] *Principles*, Chap. VI, 2d ed., p. 133. Note the clear-cut distinction between extensive and intensive margins.

[3] *Principles*, Chap. VI, 2d ed., p. 116.

Two questions arise with regard to this statement of the case: first, what minimum limit to profit is there? In the above quotation, Ricardo admits a minimum, — with what significance will appear in a moment, — saying that some portion of the £720 wages-plus-profits aggregate must always be left for profits. Elsewhere he states that "long before" profits were reduced to nil "there would be no motive for accumulation;" [1] "profits must be sufficient to afford an adequate compensation for their trouble, and the risk." [2] Thus there is some implication of an abstinence idea, but it is carried no farther, and is not brought into connection with the general theory of profits.

The second question is: how is the margin determined, that is, what limits the amount of the wages-plus-profits aggregate (£720)? That this question concerns a maximum point for profits, will at once be perceived. Now it cannot be said that the necessity for paying a subsistence wage fixes a maximum limit for profits, unless the margin at which the wages-plus-profits aggregate is just yielded, is determined by wages payment alone. If there is, for example, a necessary minimum rate of profit, the wages-plus-profit aggregate, and the margin, will be modified by profits to that extent; and the upper limit of profit payment becomes elastic in so far as wages are concerned. In order to give the minimum profit, the marginal return might have to be higher, and the aggregate be, not £720, but, say, £800.[3]

Ricardo's *general argument* would mean that the wages would be the only necessary expense. The farmer would push cultivation to less productive levels till, at the margin, wages only would be paid. Ricardo, however, himself recognizes that a minimum payment is necessary for capital, and, perhaps unconsciously, admits that the position of the margin must be affected by such necessity. This being true, what prevents profits rising to any height, according to the scarcity of capital, simply necessitating a higher, more productive margin? The wages-plus-profits aggregate would be greater. Higher profits would be possible. Wages and profits might rise at the same time.

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[1] Note the productivity idea implied.

[2] *Principles*, Chap. VI, 2d ed., pp. 126–127.

[3] Jevons was probably the first to criticize thoroughly the Ricardian theory along the line here followed. See his *Theory of Political Economy*, London, 1871, pp. 256 ff.

The truth is that profits are not dependent upon wages, but are independently determined, in the sense that wages are.

Ricardo thought that with progress in civilization, profits tend to fall. This would not be due to a competition of capitals, to which he allowed but a temporary effect, but to a lowering of the margin of cultivation following increased demand for food and rising prices. High prices for necessaries, high wages, low profits, — this is the tendency. "This tendency, this gravitation as it were of profits, is happily checked at repeated intervals," however, by improvements and discoveries in machinery and agricultural science.[1]

One result of Ricardo's teaching was an emphasis on the idea that there is a natural and inevitable struggle of classes. Put very generally, and in another way, it was Ricardo's idea that the share of the landholder increases, and that it does so at the expense of any real increase in the shares of labor and capital. He taught, moreover, that the laws of nature make for a perpetual struggle between capitalist and laborer, which is certainly a gloomy view. "There can be no rise in the value of labour without a fall of profits. If the corn is to be divided between the farmer and the labourer, the larger the proportion that is given to the latter, the less will remain for the former. So, if cloth or cotton goods be divided between the workman and his employer, the larger the proportion given the former, the less remains for the latter."[2] Adam Smith had already hinted at these pessimistic doctrines, but he did not bring them out with such clearness and precision as did Ricardo. (As implied elsewhere in this chapter, Ricardo, while a follower of Adam Smith, was far from being a mere expositor of his predecessor.)

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[1] *Principles*, Chap. VI, 2d ed., p. 124.

[2] Chap. I, § 4, 3d ed.

Ricardo's Ideas on Surpluses. — The Physiocrats made much of the idea of the return from land as a unique surplus; their *produit net* was a sole surplus over costs, arising from the bounty of nature. Ricardo, as indicated in the section on rent, also treated rent as a surplus, while basing it upon the niggardliness of nature.

At points, however, he suggests the existence of other surpluses. Labor, he says, may sometimes receive a surplus; and, above all, he makes some remarks concerning profits which would seem to indicate that he regarded them in part as something over and above cost. In this matter, he is not consistent,[1] having probably not given it distinct consideration. Thus his discussion of the wages-plus-profits aggregate, taken in connection with his idea of a minimum subsistence wage, would leave profits as a varying residuum, containing presumably an element of surplus. Also he states that taxes can be made to rest upon profits, and that savings can be made from them,[2] which would lead to a similar conclusion. On the other hand, he conveys the idea of the necessity of profits as a motive for accumulation and as a compensation for risk and trouble; and at one point he says that a tax on profits would raise prices.[3] Again, the tendency of profits to a minimum (later worked out by Mill) is suggested.

These various ideas were not connected and correlated by Ricardo. It does not seem fair to say more than that his treatment is wavering, and that had he been put to it he would, when assuming competitive conditions, probably have made profits a cost, not a surplus.

Money; Foreign Trade. — Other notable features of Ricardo's work are his discussions of money and foreign trade. In his famous pamphlet on *The High Price of Bullion*, he distinguished money from "other capital," and developed the idea of an equation of exchange depending upon rapidity of circulation, confidence, and bank credit policies, as well as upon the quantity of the medium of exchange. By taking the general level of

[1] See Chap. XXVI.

[2] 2d ed., p. 441.

[3] *Ibid.*, p. 245.

prices for granted, he avoids the error of the "quantity theory" of money value. He concludes that no mere change in the quantity of money can change the ratio of its total value to the total value of all goods. Ricardo was a "hard money" man, and proposed as the remedy for inflation a gradual reduction of notes in circulation until the remainder should have "equal value with the coins they represent." As to foreign trade, he emphasized the ability of acquiring goods cheaply through international division of labor,[1] and partly worked out the idea of comparative cost, though on this last point he may well have drawn upon Colonel Robert Torrens.[2] The idea that trade among nations is automatically governed by changes in relative prices, which check or increase imports, was clearly stated.

✓**Philosophy and Method.** — There is relatively little to be said concerning Ricardo's philosophy, and that largely by way of implication and inference. He was no philosopher. But one of his training and motive easily became utilitarian, and utilitarian in the narrower materialistic sense. He was interested in material things; he was an individualist; his citizen was the "economic man"; he had the idea of an indefinite sum of satisfactions — there was no limit to the desire for enjoyment. As he stated in his *The High Price of Bullion,* he believed that in most cases where competition is free, "the interests of the individual and that of the community are never at variance." The exportation of specie, for example, may always be safely left to the discretion of individuals, — anyhow, no laws can stop such exports if individuals find them advantageous.

These characteristics stamp the utilitarian political economists of the early nineteenth century,[3] Bentham (1748–1832), James Mill, M'Culloch, etc., and Ricardo followed tacitly. James Mill was his friend and mentor, and, through Mill, Ricardo met Bentham, the man who above all others gave the Classical School of Political Economy its ethical point of view.

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[1] J. S. Mill elaborated Ricardo's doctrine. See below, p. 458.

[2] Torrens, *An Essay on the Corn Trade,* pp. 264–265 (1815).

[3] Bonar, *Philosophy and Political Economy,* pp. 218–219.

It may be said, then, that Ricardo was hedonistic, and certainly he was at heart a materialist. His economy was what certain writers have called "primitive." In it, the forces of nature were dominant, and man was ruled by environment. "Social progress," and the ideal, played a small part in it.

Ricardo's economic philosophy was that of the manufacturing middle classes of contemporary England which developed with the factory system. He was a free trader, and he believed in the effectiveness of competition, though, like Bentham, he can hardly be classed as a member of the "Manchester School." He taught that rent is an unearned deduction from other shares, increasing in a declining state; while profits (and interest) rise with progress, betokening an identity of interest between society and capitalists. Profits, moreover, depend on wages, the implication being that low wages are desirable, at least if by low wages is meant wages that are low as compared with the efficiency of the laborers.

Ricardo breaks with the Physiocrats, Smith, and Malthus. He stands for the newly dominant class, attaching an importance to profits that is similar, in a way, to the attitude of the earlier economists toward the land-rent surplus.

Indeed, while in a sense Ricardo reacts from Smith to the Physiocrats in his conception of the scope of economics, emphasizing Distribution as he does,[1] his idea of the problem of Distribution is vastly different from that of the Physiocrats, and he deals a great blow to the remnants of the ideas of productivity and nature philosophy handed down by both Quesnay and Smith. *One of his great services lay in the fact that, more than any predecessor, he separated economics from other branches of knowledge, and from ethics and government, in particular.* With Ricardo, Political Economy became Economics.

In brief summary, we may say that Ricardo's thought differed from Smith's in that it was dominated by hedonism, unalloyed with "nature philosophy" or "moral sentiment," and by the phenomena of the factory system as contrasted with economy of the "domestic system."

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[1] In a celebrated letter to Malthus, Ricardo wrote: "Political Economy you think is an enquiry into the nature and causes of wealth; I think it should rather be called an enquiry into the laws which determine the division of the produce of industry amongst the classes who concur in its formation."

In spite of all the foregoing points, however, it would be unjust to overlook Ricardo's wise and broad-minded recognition of the difference between "national riches" and individual values, and of the importance of standards of living. These things show that his utilitarian individualism was for him merely the working premise which, in view of his environment and the condition of the science, seemed most expedient.

Much might be said on Ricardo's method.[1] Perhaps no other economist has been so abstract and hypothetical as he. In all that he says concerning value, he does not adduce one single illustration from actual life. Not even one historical or statistical fact is brought forward to support his conclusions. Inside of two pages no fewer than thirteen distinct suppositions, all of them purely imaginary! The whole discourse is hypothetical. The deficiency of this method has already been commented upon in discussing Ricardo's theory of wages.

Again, his method is clearly abstract and deductive. There is a considerable element of truth in regarding Smith's work as combining two methods, and in thinking of Malthus and Ricardo as pursuing the one and the other. For weal or woe, Ricardo long possessed an unparalleled ascendancy over English economic thought, and not the least effect of his sway was the prominence given the method he followed. From a few premises he builds up his system like a mathematical proposition. But his premises are often taken for granted. They consist either in the doctrines of Smith, or in some broad induction of his time, as the law of diminishing returns. Enlightened self-interest, competition, the naturalness of existing institutions, are assumed. Then all "disturbing" factors are practically disregarded. Highly simplified single causes are taken, and an acute and generally accurate deduction follows. The trouble generally lies in the premises; for there is almost no verification by facts. Though not entirely so, Ricardo's thought is relatively free from *inconsistency.*

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[1] See Keynes. *Scope and Method of Political Economy*, pp. 222 ff.

The very narrowness and absolutism that went naturally with such methods, were for the time a source of strength. The confusion in Smith's statements had been worse confounded by the breaking out of the Industrial Revolution, and men wanted rules. Their feeling then was that of De Quincey, when he said: "Mr. Ricardo had deduced, *à priori,* from the understanding itself, laws which first gave a ray of light into the unwieldy mass of materials, and had constructed what had been but a collection of tentative discussions into a science of regular proportions, now first standing on an eternal basis." [1]

It has been suggested that Ricardo's much-extolled logical power was due to the fact that, being a business man and of foreign stock, he was blind to the traditions of English institutions and thought, thus pursuing a straight course through inability to see the crooked branch roads.[2] But while this suggests some modification, the general belief in Ricardo's powerful and acute deduction seems just. In his abstract narrowness lay no small share both of his weakness and of his strength.

Ricardo's Followers. — The only immediate followers of Ricardo's economic ideas who are worthy of note are James Mill (1773–1836), J. R. M'Culloch (1789–1864), and Thomas De Quincey (1785–1859).

James Mill, father of John Stuart Mill, was a philosopher and historian of no mean powers. His chief economic work, entitled *Elements of Political Economy* (1821), aimed to be an epitome of accepted economic doctrines. In it he presented extreme views on the labor theory of value, and a pessimistic interpretation of the Malthusian principle. The father had much influence upon his great son's thought, and was effective in stimulating Ricardo to publish.

M'Culloch was a less original thinker than Mill, but his chief economic work, *The Principles of Political Economy* (1825), was widely read both in England and on the Continent, its effect being seen in the work of Laveleye, notably in the treatment of those conditions upon which the productivity of labor depends. He held views on value like those of Mill, and is notable as an early exponent of the wages-fund theory, a theory which he set forth in an *Essay on the Circumstances which determine the Rate of Wages and the Condition of the Labouring Classes* (1826). M'Culloch was also active in statistics and in the bibliography of economics.

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[1] *Confessions of an Opium Eater,* quoted by Toynbee, *Ricardo and the Old Political Economy,* p. 2. See this essay for Ricardo's influence, the grounds for it, and his limitations.

[2] Patten, *Development of English Thought.*

De Quincey wrote *Dialogues of Three Templars* (1824), defending a narrow interpretation of the Ricardian theory of value, and the *Logic of Political Economy* (1844), in which he emphasized the importance of utility, and made significant suggestions concerning the theory of rent.

These men were friends of Ricardo's; they were possessed of excellent powers of exposition; and they contributed in no small degree to the effective dissemination of his theories.

3. OPTIMISTIC TENDENCIES

Though one should refrain from calling Malthus and Ricardo pessimists, they did bring out the dark side of Smith's thought. They developed pessimistic tendencies. But while the English Classical economists were working out an analysis which contained so many seeds of pessimism, the optimistic tendencies noticed in the *Wealth of Nations* were not without defenders. Those who clearly developed and emphasized these tendencies were mostly Frenchmen and Americans. From the Physiocrats on, optimistic views have, on the whole, obtained among French thinkers, though there have been some notable exceptions. The ever-lurking idea of a beneficent law of nature or a natural harmony of interests, worked in this direction. Perhaps, too, the buoyancy of the national psychology of the French might be mentioned in this connection, together with their well-known love of harmonious system. With them, moreover, the closely related philosophy of individualism has been fostered by a prevalence of small landed proprietors, shopkeepers, and manufacturers, which has existed down to the present day. And their long warfare against the various phases of Communism and Socialism, as well as revolutionary tendencies in general, have doubtless helped to confirm this natural tendency. As for America, her "boundless" natural resources and rapid industrial progress forbade serious pessimism.

Accordingly a group of economists who doubted the law of diminishing returns, must now be considered; economists who challenged the Ricardian doctrine of rent; who criticized or rejected the Malthusian principle of population; and who believed that the interests of the various classes are in harmony. Though probably less influential in shaping the stream of pure economic theory than the less optimistic economists, they have served as a counterpoise, and have at points furnished the needed criticism and correction.

As characterizing schools of economic thought, neither optimism nor pessimism is to be taken as fundamental: both are but symptoms, indicating the existence of certain ideas or theories more essentially connected with the science. In fact, many economists cannot be classed as being either optimistic or pessimistic; while optimism or pessimism may be based upon widely different grounds. At least two classes of optimists are to be distinguished, one being materialistic and believing in *laisser faire,* the other idealistic and believing in social reform.

The materialistic type of optimist is well represented by the French economist, J. B. Say, and such followers as Dunoyer, Garnier, and Chevalier. The German, J. H. von Thünen, and some of the leaders of the Austrian School, may also be classed here. They were all believers in the general efficacy of *laisser faire* and the soundness of individualism. Their optimism arose from a conviction that by leaving things alone and allowing free play to the force of nature a beneficent social order may be established.

Idealistic optimists base their hopes on social reform. They believe that by taking thought and adopting perfected social arrangements, man may overcome environmental limitations and make progress toward the ideal state. Such thinkers are apt to have considerable faith in the perfectibility of human nature and institutions, as did Godwin and other sentimental Socialists. John Stuart Mill and Arnold Toynbee may also be mentioned as illustrating the type. The German economist Friedrich List, who was optimistic to a degree, emphasized social arrangement in the shape of national organization.

Probably the two most outstanding optimists, however, were Henry C. Carey and Frédéric Bastiat, whose thought will be the subject of the next two chapters.

These economists came as near as possible to making optimism the most prominent characteristic of their teaching. They illustrate the difference among optimists, however, for Carey was more idealistic in reasoning about man's power over nature and the potency of human institutions; while Bastiat showed more of the influence of Say in his *laisser-faire* teachings.

CHAPTER XIV

CAREY AND THE "AMERICAN SCHOOL"

In so far as anything like a distinctively American school of political economy existed during the course of the eighteenth and nearly the whole of the nineteenth centuries, its characteristics were those to be expected from the history of the country and its economy. Americans were filled with a great desire to build up the economic independence of the young nation, and this spirit was coupled with an optimism born of apparently inexhaustible natural resources. As will be seen, the thought of Henry C. Carey was the culmination of these factors.

It should be noted in advance that this early American economist may be said to have had a dual system of thought; or he may be called philosophically inconsistent. In some respects, he so differed from the Classical economists that one is tempted to list him as an out-and-out opponent. In certain important essentials, however, he agreed with the Classical thought, and we therefore divide our treatment of him, this chapter presenting him as a critical follower of Adam Smith, while a later one will deal with his most important departure, namely, his "Nationalism." Carey, on the whole, accepted a concept of economics based upon the price system, and he presents a theory of value of the same general type as the Classical theories. He appears to have had a concept of the problem of distribution which enabled him to rely upon the automatic working of social laws. No one would think of Bastiat as an opponent of the Classical economics, or as a Nationalist; yet the economic theories of Carey and Bastiat are so similar that historians still differ as to which of the two was the originator. We must, therefore, distinguish Carey's general economic theory from his Nationalistic protectionism.

Predecessors of Carey. — Carey was preceded by Franklin, Hamilton, and Raymond; and a paragraph may well be devoted to each of these earlier thinkers.

Benjamin Franklin,[1] who might be called the first American economist, lived while America was still a group of British colonies, and he was much affected by European thought. He had some just ideas on money and on population. His work *On the Price of Corn and Management of the Poor* was published in the London *Chronicle* in 1766, and was later reprinted in M'Culloch's collection of scarce and valuable tracts. Franklin was personally acquainted with some of the Physiocratic thinkers, and held ideas on productivity similar to theirs.

Alexander Hamilton (1757–1804) was a lawyer and statesman, — one of the greatest statesmen produced by America, — and his economic views are to be drawn chiefly from his state papers on finance. During the years 1790 and 1791 he discussed in a lucid, temperate, and weighty manner the economic questions which confronted the nation: the public debt, money, banks, protection of manufactures. Hamilton favored bimetallism on grounds of expediency; showed the advantages of using public credit and of a national bank; and forcefully stated the grounds for government intervention to encourage industry, as opposed to the general *laisser-faire* position.[2] In denying the argument that labor is more productive in agriculture than manufactures, he clearly suggests the idea that land is but a form of capital,[3] an idea characteristic of the "American School."

Hamilton's refutation of the Physiocratic argument was couched in the following language: —

> "To affirm that the labor of the manufacturer is unproductive, because he consumes as much of the produce of land as he adds value to the raw material which he manufactures, is not better founded, than it would be to affirm that the labor of the farmer, which fur-

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[1] See Wetzel, Johns Hopkins University Studies, Vol. XIII, pp. 425 ff.; also above, p. 260, note 1.

[2] *Amer. State Papers*, Finance, Vol. I, p. 128. *Alex. Hamilton als Nationalökonom* is the title of an inaugural dissertation (Halle) by Harrower (1887).

[3] *Ibid.*, p. 124 (1791).

> nishes materials to the manufacturer, is unproductive, because he consumes an equal value of manufactured articles. . . . Each destroys a portion of the produce of the labor of the other. . . . In the meantime the maintenance of two citizens, instead of one, is going on; the State has two members instead of one; and they, together, consume twice the value of what is produced from the land."

Other characteristic features are the emphasis he laid upon building up domestic manufactures in order to develop a home market for agricultural produce,[1] and a note of optimism.

Hamilton probably exerted some influence on Friedrich List, of whom more later.

Daniel Raymond [2] published his *Political Economy* in 1820. It shows several points of similarity to Hamilton's ideas, and classes its author as a forerunner of Carey. Like Carey, Raymond was on many points opposed to the cosmopolitanism of the Classical School. He favored a protective tariff, and argued at length for internal freedom of trade while demanding restrictions on imports. In this connection, he shows the American school's characteristic animosity toward England. It was not for old Europe, burdened with chronic evils, to develop the true political economy, he maintained, but for vigorous young America. Raymond followed Lauderdale in opposing individual to social interests, distinguishing wealth from value. That is, he opposed the exchange-value idea of wealth, and insisted that facility of acquiring the necessaries and conveniences of life by labor should be requisite for increased wealth. He criticized the Malthusian principle of population. He also virtually ignored the law of diminishing returns, and classed land with capital. Raymond was dogmatic in tone, and both assumed theological premises and emphasized "laws of nature." The writers to whom he refers are Ganilh, Montesquieu, Quesnay, Smith, Lauderdale, and Malthus.

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[1] His arguments for manufactures were summed up under seven heads: —

1. Division of labor.
2. Extension of use of machinery.
3. Additional employment to those classes of the community not ordinarily engaged in business, — women, children, and others.
4. Promotion of emigration from foreign countries.
5. Greater scope for the diversity of talents and dispositions, which discriminate men from each other.
6. More ample and varied fields for enterprise.
7. "The creating, in some instances, a new, and securing, in all, a more certain and steady demand for the surplus produce of the soil." (See *ibid.*, p. 125.)

[2] See Neill, C. P., *Daniel Raymond: An Early Chapter in the History of Economic Theory in the United States*, Johns Hopkins University Studies, Vol. XV, pp. 217–281.

A. H. Everett (1792–1847) deserves more mention as a forerunner of Carey, in that he published a book in 1823, called *New Ideas on Population,* in which he maintained that population means abundance, on account of the increase in skill, division of labor, and invention, which it brings. He was a protectionist.[1]

Contemporary with Everett was Willard Phillips (1784–1873), a writer whose thought, while based on the Classical doctrines, shows some of the tendencies common in his country and time.[2] "National production" is his chief concern, and he favors various bounties and restrictions. Although not at first an advocate of the protective system, he later became one.[3] Population is little mentioned, while the inexhaustible treasures of the earth are dwelt upon, and rent is said to depend upon the abundance of land. Demand is made the force upon which value depends; and instead of a subsistence theory of wages, we find something which may be called a productivity theory.

This early reaction of American thinkers against the Classical School is a matter of considerable interest.

These men, however, are of very slight importance in the development of the world's economic thought. In fact, until the late years of the nineteenth century, the United States did little to advance the social sciences. President McCosh of Princeton could say that America had produced only one metaphysician, President Edwards. So in the history of political economy America long had but a solitary name, that of Henry C. Carey.

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[1] See "British Opinions in the Protecting System," *North Amer. Rev.* XXX, 160; "American System," *North Amer. Rev.* XXXII, 127.

[2] *Manual of Political Economy* (1828). Phillips refers to the following writers: Necker, Lauderdale, Say, Smith, Malthus, Lowe, Montesquieu, Locke, Ricardo, Franklin, Mirabeau, S. Gray, and others.

[3] *Protection and Free Trade* (1850).

Able Americans like Alexander Hamilton wrote well on politico-economic subjects; but they added nothing important to the science of Economics.

Nor is it gratifying to think that America's best-known representative in the history of political economy should frequently be regarded as great chiefly in his errors. All allow that Carey was a man of intellectual ability and original power; but it is not so much by the truth he discovered that he advanced science. More often he presented error in such manner that it required reflection, observation, and close thinking to refute it.

Carey's Life and Works. — Henry Charles Carey was born in Philadelphia in 1793. His father was Matthew Carey, an Irishman who had emigrated from Dublin on account of political persecution, and had founded a publishing house in Philadelphia. Henry C. Carey was well educated, and became partner in his father's business in 1814, taking upon himself the entire management of it in 1821. He established the auctions of the publication houses which have become so important in the book trade in this country. Having acquired a fortune, he retired from business in 1835, and devoted the remainder of his life, upwards of forty years, to study and literature, in particular to the development of his system of social and political science. He endeavored to employ his resources in such a manner as to benefit mankind. He died in 1879 at the advanced age of eighty-six.

The following are his principal writings: *An Essay on the Rate of Wages, with an Examination of the Causes of the Difference in the Condition of the Labouring Population throughout the World,* published in 1835; *Principles of Political Economy,* in three volumes, published between 1837 and 1840 (an enlargement of the work first named, and containing the most important part of his system); *The Credit System of France, Great Britain and the United States* published in 1838; *An Answer to the Questions: What constitutes Currency? What are the causes of its Unsteadiness? and What is the Remedy?* in 1840; *The Past, the Present, and the Future,* in 1848; and the *Harmony of Interests, Agricultural,* *Manufacturing, and Commercial,* in 1851. In this last work Carey establishes his theory of protection. Two years later, i.e., in 1853, he published *The Slave Trade, Domestic and Foreign: how it exists and how it may be extinguished,* and also *Letters on International Copyright.* Carey's most important work, however, was his *Principles of Social Science,* published in three volumes, in the years 1857–1860. In this work he has given us his complete system and repeated all the ideas and doctrines in his previous works which he considered new and important. The *Principles* was condensed into one volume by Kate McKean, and was published in 1864, with the author's approval.

Value. — As with Bastiat, so in Carey's case, value is the center of a System of Harmony. Carey's is a labor theory. Value is determined by the amount of labor required for production at the present time, or for reproduction at any given time. As he puts it, value is caused by the obstacles to production, and measures nature's power over man. He is more consistent than Bastiat in confining the term "utility" to signify man's power over nature, a conception which Bastiat designated by the phrase "gratuitous utility."

Social Progress and Distribution. — Carey includes land with capital, since he regards the former as a product of human effort.[1] He concludes that with progress, the shares received by labor and capital both increase; but not at the same rate, for the laborer's share, wages, increases relatively to that of capital (and land). Thus, to illustrate the idea, he constructs tables similar to the following: —

	Total Product	Capital's Share	Labor's Share
1st land	100	80	20
2d land	200	120	80
3d land	300	150	150

This conclusion rests upon his theory of value and his optimism: labor increases in productiveness, less labor is required to produce things, and so less labor will be given for products past or present. Accordingly the value of man rises as compared with capital.

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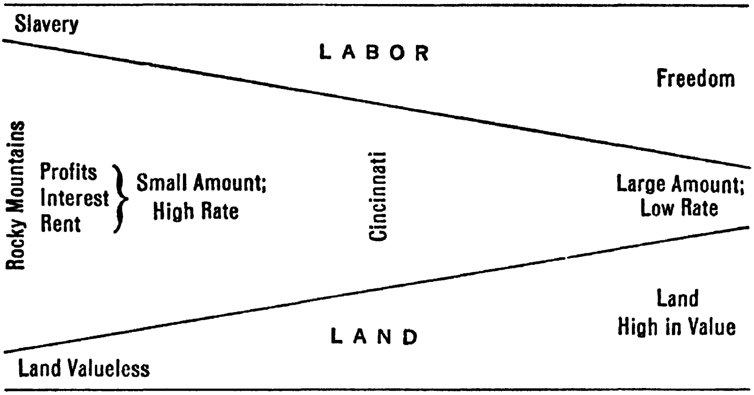
[1] Mental and physical strength are also included!

The whole scheme is graphically represented thus: —



With progress, "societary circulation" becomes more rapid; capitalists can demand only lower rates, but receive larger aggregate amounts; wages increase absolutely and relatively; and industrial classes tend toward equality; — so runs the harmonious order of events!

Other Theories. — The three principal points in Carey's system to be considered further, are his theories concerning Rent, Population, and Protection.

Protection will be treated of in discussing the opponents of Adam Smith, for Carey may be considered as ranking among them in that regard. Carey's doctrines of Rent and Population are aimed at Ricardo and Malthus. It may seem strange that Carey should be considered a follower of Adam Smith, since he contends against Ricardo and Malthus, also followers of Smith. But the existence of contradictions between different statements made by Adam Smith has been pointed out, and it was possible for two opposing schools to trace their origin to him. Carey, accordingly, holds Smith in considerable estimation, while condemning some of his English followers in strong terms.

Rent. — In his *Principles of Political Economy*, Carey assented to Ricardo's opinion that the best lands are cultivated first. He did not, however, even then acknowledge that Ricardo's theory of rent was correct; since he held that the value of commodities depends upon the cost of reproduction, and that the cost of producing agricultural commodities, or food and raw material, decreases with general progress.

He felt, however, that his theory was still incomplete. In the preface to his *Principles of Social Science* he says of the earlier work: —

> "He had already satisfied himself that the theory presented for consideration by Mr. Ricardo — not being universally true — had no claim to be so considered; but it was not until ten years later that he was led to remark the fact that it was universally false. The real law, as he then saw, was directly the reverse of that propounded by that gentleman, the work of cultivation having, and that invariably, been commenced on the poorer soils, and having passed to the richer ones as wealth had grown and population had increased. Here was the great fundamental truth of which he before had thought, and the one, too, that was needed for the perfect demonstration of the truth of those he previously had published. Here, too, was further proof of the universality of natural laws, the course of man in reference to the earth itself being thus found to have been the same that we see it to have been, in reference to all the instruments into which he fashions the several parts of the great machine. Always commencing with the poorest axes, he proceeds onward to those of steel; always commencing with the poorer soils, he proceeds onward to those richer ones which yield the largest return to labor, the increase of numbers being thus proved to be essential to the increase in the supply of food. Here was a harmony of interests directly opposed to the discords taught by Mr. Malthus."

This great law, as Carey calls it, was first announced to the world in 1848 in *The Past, the Present, and the Future.*

Carey maintains that experience shows that at first men take up poor soils, because they are light and sandy and easier to cultivate. Men begin to cultivate the hills, and when the poorest land is exhausted and numbers and knowledge have increased, they work down toward the rivers and make use of the rich valleys. The last settlers, therefore, receive the best land.

Labor becomes continually more productive, wealth increases, and man progresses.

The earth is only the material of a machine which the agriculturist makes and calls a farm. He can obtain for it at most only what it has cost him, for plenty of this material remains, and others will construct machines for themselves rather than pay more. In fact, the farmer cannot, as a rule, obtain so much for his machine as it cost him, because the material remaining is better and man learns how to work with less cost. He is able to obtain only what it would cost to *reproduce* it. It is the same as with an ax which may have been manufactured ten years before. The owner cannot obtain what it cost him, but only what it would cost to make another one at the present time. There is no essential difference between the farmer and any other capitalist. The farm simply represents so much capital.

Carey seeks the aid of history in the development of his theories, but his knowledge appears to have been as limited as his critical faculty. It is true that, in many places, people have first settled on high land, but some of the causes which have led them to do so have not been at all of an agricultural nature, as for example the desire for defense or to secure freedom from disease.[1] As was easy under the circumstances, he overestimated his discoveries and gave them a universality which does not belong to them. It is going too far to intimate that the poorer lands are always first cultivated, however the quality be estimated. Can any one imagine that a farmer who has the choice would deliberately pick out that land for cultivation which yields the least return to his labor and capital? As Lange says: "Even unfruitful heaths and hillsides are gradually brought into a state of cultivation. This is what I see every day in my home on the lower Rhine and in Westphalia, where agriculture and manufactures flourish together, and is therefore a fact which no Carey can convince me to be untrue." [2]

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[1] See Hibbard, *History of Agriculture in Dane County*, Bul. of the University of Wisconsin.

[2] *Angebliche Umwälzung der Socialwissenschaft durch Carey.*

Again, Carey clearly does not understand Ricardo's theory, or at least does not represent it fairly. The fruitfulness of land is a relative conception. If a certain amount of capital and labor will yield more when applied to a light than to a heavy soil, the light soil is, in the sense of Ricardo's theory of rent, the more fruitful, although it may be possible to produce more on the heavier soil by applying a greater amount of labor.

It may be that Ricardo himself did not bring this out with sufficient clearness. In fact, it is owing to Carey's opposition that Ricardo's followers have been led to explain so precisely as they have what is to be understood by good, better, and best land. Carey attacked Ricardo with so much force and ability that it compelled economists to go over again the whole ground of the theory of rent. The result has been a correction and amplification. This is Carey's service.

Population. — Carey held Malthus to be wrong, first because he maintained that the Malthusian theory is contrary to God's attributes. He begins the chapter (xxxviii) on population thus: "'Be fruitful and multiply,' said the Lord, 'and replenish the earth and subdue it'"; and after describing briefly Malthusianism, as he understands it, adds: "Can such things be? Can it be that the Creator has been thus inconsistent with Himself? Can it be, that after having instituted throughout the material world a system, the harmony of whose parts is absolutely perfect, He has of design, subjected man, the master of all, to laws which must produce universal discord? Can it be, that after having given to man all the faculties required for assuming the mastery of nature, it has been a part of His design to subject him to laws in virtue of which he must become nature's slave?" It hardly seems necessary to criticize this position.

A second argument is deduced from the harmonious laws of nature. As the earth is cultivated, the lower races of animals die out and the supply of carbonic acid tends to diminish, since animals generate and plants consume that gas. It is therefore necessary that the numbers of the human race should increase in order to furnish the vegetable world with the necessary amount of carbonic acid. It is doubtful if Carey's dilettanteism in natural science ever led him to a rasher hypothesis. In the first place, aside from any question as to where the carbonic acid comes from, it may be fairly doubted whether the amount generated by man or the lower animals has any appreciable effect on vegetation. In the second place, it might with equal propriety be argued that the number of mankind ought to decrease, since the great amount of coal now consumed as fuel is increasing the supply of carbonic acid gas so rapidly as soon to upset all natural and harmonious arrangements!

A third argument used by Carey is that the increase of numbers means increase of wealth. The more hands, the more producers of wealth. The greater the number of inhabitants, the greater the combination and division of labor.[1] To a certain extent this is true. It must simply be remembered that labor is only one element of production, while increase of wealth depends upon the harmonious development of the three elements, land, labor, and capital, to say nothing of enterprise.

Carey next argues that it is absurd to suppose that man alone increases in geometrical ratio. The lower animals, which furnish him with food, increase as rapidly, and even more rapidly. A single grain of corn produces hundreds of grains, and these if planted will increase in like number. That is geometrical progression. "The progeny of a single pair of carp," says Carey, "would in three years amount to thousands of billions; that of a pair of rabbits would in twenty years count by millions; whereas that of a pair of elephants would not number dozens. When, however, we reach the highest form, we hear of a new law, in virtue of which man increases in a geometrical ratio while increase of the commodities required for his use is limited to the arithmetical one."[2]

J. S. Mill's reply is to the point. "Mr. Carey," he says, "expatiates on the absurdity of supposing that matter tends to assume the highest form of organization, the human, at a more rapid rate than it assumes the lower forms which compose human food; that human beings multiply faster than turnips and cabbages. But the limit to the increase of mankind, according to the doctrine of Mr. Malthus, does not depend on the power of increase of turnips and cabbages, but on the limited quantity of the land on which they can be grown. When Mr. Carey can show, . . . not that turnips and cabbages, but that the soil itself, or the nutritive elements contained in it, tend naturally to multiply, and that too, at a rate exceeding the most rapid possible increase of mankind, he will have said something to the purpose. Till then, this part, at least, of his argument may be considered as non-existent."[1]

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[1] Everett in a book on *Population* (Boston, 1823) had made this argument.

[2] *Social Science*, p. 57.

A further argument used by Carey is the same as that advocated by Herbert Spencer in his *Biology*. It is only one of a number of striking resemblances between them, and Carey's works were published first.[2] The position taken by Carey is that there is an antagonism between the intellectual and generative functions, and that the growth of population tends to decrease in rate as man becomes more highly developed, so that the supply of men is made equal to the demand by a self-acting law. Carey is able to give no proof for this position, however, for statistics such as he cites may be found on both sides. This very plausible idea remains a mere hypothesis to this day.

Philosophy and Method. — Carey's philosophy is, after all, rather simple and easily understood. It is highly charged with that sort of idealism which has animated the growing American nation. He believed in the conquest of nature by man: association spreads; mental power supersedes muscular; man's control over nature grows. With similar significance the power of the state is confidently invoked to give America industrial independence. And there is manifest an allied tendency to take the subjective point of view.

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[1] *Principles of Political Economy*, Bk. I, Chap. X, § 3.

[2] It should be noted, however, that in an article published in the *Westminster Review* in 1852, Spencer argued that when the world becomes duly populated the pressure of population must gradually come to a close. This was some six years before Carey's *Social Science*, and it is not unlikely that he drew upon the article to some extent.

Carey's method may be considered as a curiosity. It is truly unique. It is a mixture of all methods. He says in one and the same breath that the English were wrong in using too exclusively the deductive method, and that the mathematical method is the correct one. He accuses others of neglecting facts for hypotheses, and himself immediately makes the most astounding suppositions. He complains that political economy has not advanced beyond the metaphysical stage of knowledge, and at the same time represents inspiration and intuition as the highest branches of the tree of knowledge, since they are the sources of other sciences. But intuition is the source of the metaphysical method, and inspiration of the theological.

Carey's fundamental supposition, the one which would perhaps logically come first, is that the laws of physical science are those of social science, since one uniform and harmonious law governs mind and matter. The laws "instituted for the government of matter in the form of clay and sand" are "the same by which that matter was governed when it took the form of man, or of communities of men." It follows that one and the same method is to be pursued in the investigation of all sciences, a conclusion which at present it would be impossible to prove. To do him justice, Carey himself does not make any attempt to do so.

As, in his opinion, the same laws govern mind and matter, society and the material universe, it is not surprising to find him employing the technical terms of physical sciences, and making use of forced analogies between social phenomena and those of external nature. He speaks of man, for example, as the molecule of society, and describes his gregarious disposition as the law of molecular gravitation. Because large cities attract more people to them than small cities, and attract more people from their immediate neighborhood than from a great distance, he feels warranted in asserting that "gravitation is here, as everywhere, in the direct ratio of the mass and the inverse one of the distance."[1]

A little reflection shows that such a statement is extremely misleading and even absurd.

Inconsistency. — Carey possessed much originality, but lacked a scientific training. His work is unsystematic and not without glaring inconsistencies. Thus he holds that better and better lands are taken under cultivation and lower prices result; while elsewhere we are told that the growth of industry makes the price of subsistence higher. While admitting that in market centers the means of life are dearest, he asserts that a dense population through the power of association makes things cheaper.

Carey's Followers of the Early American School. — In so far as an American School of political economy was ever spoken of in the nineteenth century, Carey and his adherents are meant. This is perfectly proper. America during that period had no other body of economists who could by any possibility be considered as forming a *school.* Carey found warm admirers on this side of the Atlantic as well as on the other. Many were ready to accept his system as proved beyond the possibility of doubt. The following may be considered as among the more noteworthy of his American followers.

First, E. Peshine Smith, who wrote a *Manual of Political Economy,* which was published in Philadelphia in 1853, and was later given a French translation. It contains an exposition of Carey's system in the form of a textbook. Peshine Smith acknowledges frankly that Carey is his master, and declares his unbounded faith in him. In his preface he says: "Mr. Carey, by showing that the fact is directly the reverse of the hypothesis of Ricardo, and by establishing the consequences which flow from it, restored harmony to what was before a mass of discordances, and rendered it possible for the *first* time to construct a science out of what was a mere collection of empirical rules." Smith explains that the object of his manual is to provide us with a truly American system of political economy.

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[1] McKean's edition of *Social Science,* p. 38.

Another author, who, though possessed of more ability and independence, was influenced by Carey, and may be classed as a member of the Early American School, attempted to do the same. This was Francis Bowen (1811–1890), formerly professor of political economy in Harvard, and author of the *American Political Economy*, published in 1870.

In his *Politics for Young Americans*, in many respects an excellent little work, Charles Nordhoff expresses strong admiration for Carey, and shows himself an undoubting disciple.

Horace Greeley wrote a work on political economy, published in Boston in 1870, the full title of which indicates its scope: *Essays designed to elucidate the Science of Political Economy, while serving to explain and defend the Policy of Protection to Home Industry as a System of National Coöperation for the Elevation of Labor.* The book is well worth reading.[1] Neither Bowen nor Greeley was dependent upon Carey to the extent that Nordhoff was, but it seems that both should be considered as belonging to the "American School."

Others who might be mentioned are Stephen Colwell, *The Relative Position in Our Industry of Foreign Commerce, Domestic Production and Internal Trade* (1850), *The Ways and Means of Commercial Payment* (1858), *The Claims of Labour and their Precedence to Claims of the Trade* (1861); William Elder, *Conversations on Political Economy* (1882); and Robert Ellis Thompson, *Social Science and National Economy* (1875), *Elements of Political Economy* (1882), and *Protection to Home Industry* (1886). In more recent times, very clear traces of Carey's influence appear in the thought of Professor S. N. Patten.

There has been no small amount of discussion over the relative originality of Carey and the French economist, Bastiat, concerning which more will be said in the following chapter.

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[1] For some further comment on Greeley's thought see article by Commons, J. R., in *Pol. Sci. Quarterly*, XXIV, pp. 468–488.

CHAPTER XV

BASTIAT AND THE FRENCH OPTIMISTS

Bastiat's Life and Writings. — Frédéric Bastiat [1] was born in 1801, in Bayonne, France. It was planned that he should become a merchant, but inheriting an estate at the age of twenty-five, he first tried agriculture with small success, and then devoted the remainder of his life to study. After pursuing various branches, his attention was attracted by the writings of some of the French economists, the most prominent of whom was J. B. Say, and political economy became thereafter his favorite study.

He became successively a justice of the peace (1831), member of the general council of his department, and, unsuccessfully, a candidate for the Chamber of Deputies.

The articles written then, and a little pamphlet written to support his candidacy for another office, were the first published expressions of his demand for non-interference of government in matters of trade and manufactures. But Bastiat's first important literary attempt appeared in 1844. It was an article in the *Journal des économistes*, "Concerning the Influence of English and French Tariffs on the Future of Both Peoples." He had been led to write the essay by a journey he had made through Spain and England. In the latter country, he had become acquainted with the leaders of the Anti-Corn Law League, and determined to do for France what they had done and were doing for England. In 1845 he published *Cobden and the League* (*Cobden et la Ligue*) to glorify "the grand movement," as he called it. And at about this time, he began a series of articles in the *Journal des économistes*, which appeared soon after as a book, with the title, *Sophismes économiques*. An English translation, called *Sophisms of Protection*, was published in 1877. This is Bastiat's chief destructive or negative work.

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[1] Cf. Gide-Rist, *History of Economic Doctrines*, pp. 322–348; Bluntschli u. Brater, *Staatswörterbuch*, art. "Bastiat" (Mangoldt); Von Leesen, *Frédéric Bastiat* (München, 1904); Böhm-Bawerk, *Geschichte und Kritik der Zinstheorien* (1884); McLeod, *History of Economics* (1896), pp. 135 ff.

In 1845 Bastiat removed to Paris and became secretary of the Free Trade Association there, and also took charge of a newspaper called *Free Trade*. After the Revolution of February, 1848, Bastiat became a member first of the Constituent and afterwards of the Legislative Assembly, in which he devoted his energies chiefly to fighting the Communists and Socialists.

Besides numerous newspaper articles, Bastiat continued to bring out at intervals essays designed to popularize his ideas, such as those on Property and Law, Justice and Fraternity, — aimed against the Socialists, — and Peace and Liberty. A number of these have been translated and published with the title, *Essays on Political Economy*.[1] All are written in a pleasing and luminous style, but have comparatively little scientific value.

A good illustration of Bastiat's method appears in his ironical "Petition of the Manufacturers of Candles, Waxlights, Lamps, Candlesticks, Street Lamps, Snuffers, Extinguishers, and of the Producers of Oil, Tallow, Rosin, Alcohol, and, generally, of everything connected with Lighting."[2] These lesser luminaries are represented as suffering from intolerable foreign competition, namely, that of the sun; and the Chamber of Deputies is besought to carry out their policy of protection to home industry by stopping all openings by which sunlight had been allowed to enter houses. The imaginary petitioners go on to argue that if it were objected that sunlight is gratuitous, the point would be inconsistent; for protection had been favored on the ground that foreign products approximate more nearly than home products to the character of gratuitous gifts!

Thus, brilliantly, with fable and irony, the masses are appealed to; but all too often the criticism, that the opponent's argument is not fairly stated, applies.

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[1] New York, 1880.

[2] *Economic Sophisms*, First Series, Chap. VII.

His most ambitious work and his attempt at a more positive and constructive contribution was the *Harmonies économiques.* The first volume alone was completed, appearing in the year of the author's death, 1850.

Economic Harmony. — a. *Value.* — Bastiat devotes no chapter to Production for he is not concerned with costs or material limitations. To him, economy lies in exchange, and Economics is the study of exchanges. Wants, efforts, satisfactions, — this is the round. But men commonly obtain satisfaction by giving something in exchange for what is desired. This involves the question of value, and, as with Carey, value is Bastiat's starting point. He founded his theory upon his definition of this term.

Bastiat criticizes various theories of value which had preceded him: utility, scarcity, labor, difficulty of acquirement, estimation, or judgment, — all these he regards as one-sided, though not totally wrong, bases for determining value.

Both the utility theory of Say and the labor theory of Ricardo err in placing value in the material of things. There are two kinds of utility, "gratuitous" and "onerous." The former consists of the materials and forces which are the gift of nature, and nothing can be exacted in exchange for it. Onerous utility lies in a service of man to man, and demands a service in return. Now to place value in matter would lead to the conclusion that the gratuitous utilities of nature may confer value. This would mean that landowners would have property in the gratuities of nature, something which Bastiat in his desire to defend the present order against the Socialists will not admit. It would be "as little justifiable as comprehensible." This same error, too, would deny productivity to services which do not result in material things. Wants and satisfactions, he thinks, are not sufficiently commensurable to serve as determinants of value, but he grants that utility is the basis of value if only we do not make it an intrinsic property of things.

Ricardo's necessity for excepting goods whose supply is absolutely limited, Bastiat argues, shows that a general law based on labor cost is impossible. Moreover, he asks, how are fluctuations in the value of things to be accounted for if their value is determined by the labor expended upon them?

Bastiat, however, would not destroy the labor and utility theories, but would correct their one-sidedness by uniting them. He comes very near to the labor-cost theory when he holds that value lies in "effort"; but he would make effort a broader term than labor, though it is not very clear just what it includes. In exchanging services or goods, only effort or onerous utility is considered, as natural forces are gratuitous. The difficulty arising from fluctuation in the value of stored-up labor, he meets by substituting for effort expended, the effort saved to the recipient or purchaser, an idea apparently suggested by Adam Smith's shift from the labor-cost to the labor-exchange point of view.[1] But to the purchaser, this means a service. Hence Bastiat's formula: "Value is the relation of two services exchanged." The effort saved, or service, is the product of one man; the want and its satisfaction are felt by another; the service, then, commands a compensation in the shape of some counter service.

b. *The Interests of Labor and Capital; Land Value.* — Although it is not material, value may pass into material. It is then capable of accumulation, that is to say, of becoming capital. But it is to be noticed that "where value has passed from the service to the product, it undergoes in the product all the risks and chances to which it is subject in the service itself." It may rise, or it may sink until it departs altogether, as might have happened to the service.

The tendency, however, of value that has become fixed in a commodity — that is to say in capital — is to sink. "The man who makes a cup today," says Bastiat, "for the purpose of selling it a year hence, confers value on it, and that value is determined by that of the service — not the value which the service possesses at the present moment, but that which it will possess at the end of the year." Owing to constant industrial improvements, the probability is that the cup can be produced cheaper at the end of the year than now. Thus, according to Bastiat, capital, which is only accumulated services, stands at a disadvantage compared with labor, that is, present services. As society progresses, — and Bastiat thinks of it as always progressing, — capital continues to occupy a more and more disadvantageous position with regard to labor. Labor has no reason to be dissatisfied.

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[1] See above, pp. 218 f.

The rent of land, too, is only a return for past services. The original and indestructible powers of the soil are not, as Ricardo would have us believe, the source of rent. No remuneration can be demanded for these, because they are the gift of nature. Land value represents previous services, such as the clearing away of forests, drainage, building of fences, fertilizing the soil, etc. But formerly, on account of the greater imperfection of labor's methods and appliances, it required more labor than would now be necessary to render such services. The landlord receives a return only for the present value of his improvements. Sooner than give him more, people will take up new land and improve that. "This shows how empty," says Bastiat, "are the declamations which we hear continually directed against the value of landed property. That value differs from other values in nothing — neither in its origin nor its nature, nor in the general law of its slow depreciation, as compared with the labor which it originally cost." [1]

Wage earners have every reason to be satisfied with their lot. Production ever becomes easier and more abundant, and the share they receive is continually augmented. From this "amelioration of the laborer's lot found in wages themselves and in the natural laws by which wages are regulated," Bastiat draws two conclusions and one corollary:

"1st. The laborer tends to rise to the rank of a capitalist and employer.

"2d. Wages tend to rise.

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[1] *Harmonies économiques*, I, p. 150.

"Corollary — The transition from the state of a paid workman to that of an employer becomes constantly less desirable and more easy."[1]

According to Bastiat, the postponement of consumption is a service rendered by the capitalist, for which he deserves payment or interest.[2] It might be supposed, then, that capitalists would have ground for complaint, but this is not so. Harmony of interests is complete. Capitalists receive a smaller relative share of the produce, but a greater one absolutely, on account of the growth of capital. Bastiat illustrates this by letting the figures 1000, 2000, 3000, and 4000 represent the total production of society at different periods of time. The division between laborer and capitalist, he maintains, would take place in somewhat the following manner: —

	Total Produce	Share of Capital	Share of Labor
First period	1000	500	500
Second period	2000	800	1200
Third period	3000	1050	1950
Fourth period	4000	1200	2800

The share of the capitalist, it is seen, descends from 50 per cent to 40, 35, and 30 per cent, while that of the laborer rises from 50 per cent to 60, 65, and 70 per cent.

The proof that the relative share of capital decreases, Bastiat finds in the fact that the rate of interest continues to grow lower as society advances. On the other hand, the absolute share of capital must increase, because capitalists would destroy or consume a part of their capital if they could obtain more for a part than for the whole.

It does not appear to occur to Bastiat that the profits of capital may decrease because the aggregate product of labor and capital is less. Let the supposition be made that a given amount of capital and labor produce at one period 1000 and at a later one only 800. Let the share of capital in the first period be 500 and in the second 450. The absolute share of capital would then have decreased, while its share relatively to labor would have increased. This supposition is quite as possible as that made by Bastiat. It might be said that in the beginning of a society, the most productive employments of capital and labor were sought out, and that afterwards capital and labor were obliged to perform work which would formerly have been regarded as unprofitable. Bastiat makes no such supposition as this, nor will he allow the thought of it to enter his mind, because it would interfere with his presupposed harmony and divine order of affairs.

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[1] *Harmonies économiques*, II, p. 73.

[2] For Bastiat's theory of interest and a criticism see Böhm-Bawerk, *Capital and Interest*, Bk. IV, Chap. III.

How marked the contrast between Bastiat's general scheme and Ricardo's! The latter believed that prices of raw materials and subsistence rise, and with them rents, this rise being, in a sense, at the expense of the other shares in distribution. But Bastiat, like Carey, maintained that the shares of both labor and capital (including land) increase, there being a more rapid increase in wages.

c. *Population.* — On the subject of population Bastiat is decidedly confused and inconsistent. Thus in the first part of his *Harmonies,* he sets out to deprive the Malthusian principle of all pessimistic aspects, arguing that the augmentation of population increases the number and effectiveness of exchanges, and hence results in a larger share in the gratuitous gifts of nature. But in the second part, in his chapter on "Population," he takes the more common view. Like Malthus, he hopes that the standard of living of the laboring classes may rise, so that their numbers will increase less rapidly. And he maintains that all sensible people follow the Malthusian idea, in postponing marriage until a competency has been acquired.

d. *Government Intervention.* — As everything in the field of value and distribution tends to work out harmoniously, if left alone, Bastiat considered that the science of government is exceedingly simple. Government performs its functions by the exercise of force, and there is only one place where it has, in his opinion, a moral right to exercise force. That is in establishing justice. The action of government is "essentially limited to the maintenance of order, security, and justice. All action of government beyond this limit is a usurpation upon conscience, upon intelligence, upon industry; in a word upon human liberty." [1] This, of course, begs the question as to the justice of present arrangements, and assumes the state of natural harmony of which he conceived, to exist in fact.

Bastiat and Carey. — To a great extent, Bastiat stood on the shoulders of Say, Dunoyer, and the American, Carey. List, too, might be mentioned in this connection. There has been some considerable dispute between the friends of Carey and those of Bastiat [2] as to which of the two originated their system of harmony. Bastiat has been accused repeatedly of literary theft. Their doctrines and even their language are undoubtedly often strikingly similar. The reader will remember Bastiat's theory that the share of labor increases both relatively and absolutely, while that of the capitalist increases absolutely but decreases relatively; and how he illustrated it mathematically. This may be compared with the following paragraph, taken from Carey's *Social Science:* —

> "In the early period of society, when land is abundant and people are few in number, labor is unproductive, and of the small product, the land-owner or other capitalist takes a large proportion, leaving to the laborer a small one. The large proportion yields, however, but a small amount, and both laborer and capitalist are poor — the former so poor that he is everywhere seen to have been a slave to the latter. Population and wealth, however, increasing, and labor becoming more productive, the land-owner's share diminishes in its proportion, but increases in its amount. The laborer's share increases not only in its amount, but also in its proportion, and the more rapid the increase in the productiveness of his labor, the greater is the proportion of the augmented quantity retained by him; and

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[1] *Op. cit.*, I, p. 4.

[2] Dühring and Lange. In the *Journal des économistes* for 1851 Carey an Bastiat themselves crossed swords on the matter.

> thus, while the interests of both are in perfect harmony with each other, there is a constant tendency towards the establishment of an equality of condition."[1]

Bastiat and Carey also have some similar ideas as regards value and utility; and there is a close parallelism in their theories of the origin of land value. Carey criticizes Bastiat's definition of value, it is true, but they both proceed from a criticism of the Classical labor-cost theory, and have an optimistic justification of the existing social order in mind.

Though some have argued that both writers were quite original in reaching the same conclusions, it seems improbable that this is the case. It is the general consensus of the best opinion that Bastiat was more deeply indebted to Carey than he would admit, and that he erred in not giving Carey credit in connection with his statement of the law of distribution and his discussion of land value. Carey impresses the reader as decidedly the more original, and on the whole his work antedated Bastiat's. It will be remembered that his *Principles of Political Economy* and *Past, Present, and Future,* containing the essentials of his doctrine, appeared in 1837 and 1848; while Bastiat's constructive work came in 1850.

On the general theory of value, however, Bastiat's main ideas seem to have been formed independently of Carey.[2]

Criticism. — In general criticism of Bastiat's work, it is to be observed that he was greatly influenced by the controversial atmosphere in which he lived. His doctrines appear unduly warped by his propaganda against protectionism and Socialism, while underlying all his argument is the unsound idea that the organization of society under *laisser-faire* competition is the most perfect that can be effected or even conceived of.

His reasoning on land value is quite erroneous. To hold that the value of land equals the expenses of rendering it accessible, clearing, fencing, etc., is untenable in the light of facts. For example, much land is now worth far less than such expenditures. His view overlooks the fact that such outlays are made with the idea that they will pay for themselves, and something more — that long ago they have been replaced and ceased to operate. The value of a good Illinois farm or a New York lot is far greater than such expenses. It is vain to argue that even the gifts of nature cannot be appropriated and be made the basis of a payment to the owner. That is not the way to meet Socialistic attacks.

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[1] McKean's ed., p. 31.

[2] See Von Leesen, *Frédéric Bastiat,* pp. 155 f.

Bastiat's limitations are well exhibited in his theory of value. The words "efforts" and "services," he uses almost as fetishes, but they explain nothing. If service means more than labor, how much more? What determines the value of the service? Bastiat gives us no adequate answer. Moreover, by confining himself narrowly to exchange value he leaves out of consideration the important phenomena of utility and subjective value.

In his *Sophisms* Bastiat cries: You protectionists cannot apply your theory as a general one. As between individuals, families, communities, and provinces you accept free trade. But you say the political economy of individuals is not that of peoples! And just here appears *his* absolutism. He does not regard national lines. He follows to the extreme the cosmopolitanism of the Classical School, many of the other doctrines of which he attempts to rectify.

On account of its shallowness and manifest disregard of certain facts of social life, Bastiat's writing has had little influence on the leaders of economic thought. Its popular influence, however, was remarkable, and it is this which has justified the devotion of so much space to it. This influence was increased by the extreme free trade party in England, called on the Continent generally the Manchester Party, after the city where it had its stronghold. But Bastiat's system has also reacted upon this party, leading it to greater extremes in doctrine. In Germany a party was also formed between the years 1840 and 1850, opposing all interference of government, and accepting Bastiat without reserve. Prominent members of this party were Prince-

Smith, an Englishman by birth, J. Faucher, Victor Böhmert, and Max Wirth.

Bastiat did not deny that the poor and unhappy existed, though he found the ground for their condition in a mere lack of freedom, and bade the laborer be content and grateful to the capitalist. His followers in Germany went still further. In their admiration of our present social organization, they denied the existence of a social problem. The world looked so happy to them that they could find no poor man in it. It became at one time quite the thing to speak of the *so-called* poor man. Cliffe Leslie says: "Political writers and speakers of this school have long enjoyed the double satisfaction of beholding in themselves the masters of a difficult study, and of pleasing the powers that be, by lending the sanction of science to all established institutions and customs, unless, indeed, customs of the poor. *Instead of a science of wealth, they give us a science for wealth.*" [1]

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[1] See his article in the *Fortnightly Review*, for Sept. 1, 1873, on "Political Economy in Germany."

4. OTHER EXPOSITORS

Thus far, the discussion of the followers of Adam Smith has served to emphasize the development of two divergent lines of thought with regard to the working out of economic forces. One has brought out the existence of conflict of interests, and the harsher possibilities; the other has seen ultimate harmony and beneficence in all. As already stated, the pessimistic tone of some of Smith's followers was due rather to the mode of their statement than to the logic of their thought; and the classification into optimists and pessimists does not have the deepest and most clear-cut significance in economic theory. Without attempting to push it further, then, other followers of the Smithian economics may be considered without regard to the hopefulness of their point of view. Indeed, it would be difficult to classify a number of them on that basis.

And first, a thinker in the direct line of evolution of the English Classical School deserves attention, one who wrought independently, but on the whole within the framework of Smith's doctrines as developed by Ricardo — Nassau William Senior.

a. In England

CHAPTER XVI

SENIOR AND THE ABSTINENCE THEORY[1]

Nassau William Senior (1790–1864) by exact and acute reasoning made such additions to economic theory that a chapter must be devoted to him. During the greater part of his life, he was outside academic circles, and he did not write a complete treatise; but he brought so keen and rigid an analysis to bear that his limited application was unusually fruitful. He was for a time professor at Oxford, and was a member of the Royal Commission of 1832, established to examine the operation of the poor laws and report remedies.

His principal work[2] was *An Outline of Political Economy* (1836) which appeared in the *Encyclopedia Metropolitana,* but was also published separately. To this outline, attention will be largely confined; and no attempt will be made to present all Senior's views. Only those portions of his work in which he made distinct contributions will be discussed.

The Scope of Political Economy. — First, is to be noted his idea of Economics as a science. In his own words: "The subject treated by the Political Economist . . . is not Happiness, but

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[1] Bowley, M., *Nassau William Senior and Classical Economics,* 1938.

[2] Other writings of importance are: —

An Introductory Lecture on Political Economy (1827).

Three Lectures on the Transmission of the Precious Metals and the Mercantile Theory of Wealth (1828).

Two Lectures on Population (1831).

Three Lectures on the Cost of Obtaining Money, and of Some Effects of Private and Government Paper Money (1830).

Three Lectures on the Rate of Wages (1831).

Four Introductory Lectures (1852).

Summary of the Ambiguities in the terms of Political Economy, appended to Whately's *Logic.*

Wealth; his premises consist of a very few general propositions, the result of observation, or consciousness, and scarcely requiring proof, or even formal statement; . . . and his inferences are nearly as general, and, if he has reasoned correctly, as certain as his premises." [1] Senior went very far in narrowing the scope of the science, and in making it an abstract and deductive one, and in this his influence on later writers was considerable, e.g., J. S. Mill and Jevons. He would have had the economist refrain from a single word of advice, and keep clear of morals and political science. Then, within his proper field, he must confine himself to deductions from a few postulates.

Senior allowed Political Economy four postulates: (1) a universal desire to obtain more wealth with the least sacrifice; (2) the Malthusian principle of population; (3) the postulate "that the powers of Labour, and of the other instruments which produce Wealth, may be indefinitely increased by using their Products as the means of further Production"; (4) the law of diminishing returns from land.[2]

In his sub-division of the field of the science, it seems clear that he foreshadows Mill's distinction between the laws of production and distribution.[3]

Senior's emphasis of the need for accurate definitions, and his criticisms of predecessors on this score, are noteworthy.

Value. — Some of his best work lies in the field of value, where the influence of Lauderdale is apparent, and especially in the analysis of cost of production. Value he defines as "that quality in anything which fits it to be given and received in exchange." The forces which determine it fall into two sets: the demand and supply of the one good, and the demand and supply of that for which it is exchanged. Supply, however, is somewhat unsatisfactorily defined as equaling the obstacles which limit quantity. Senior is here filled with the idea that it is merely limitation of supply, as such, that functions in value, and justly criticizes Ricardo's classification [1] for omitting this idea in the case of reproduceable commodities.

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[1] *Political Economy* (reprint, 6th ed., 1872), p. 2. See also *Four Introductory Lectures* for his views.

[2] *Ibid.*, p. 26.

[3] *Ibid.*, p. 3.

It is one of Senior's merits as a thinker that he sought to free economics from circuitous logic. This is manifest in his effort to make the concepts of demand and supply which he used, independent of price; and his idea of supply would have made it a much more significant factor than a mere price-determined quantity.

Abstinence and Capital Formation. — Just here comes Senior's great contribution, the concept of "abstinence" as a cost of production. With equal competition, goods sell for their cost of production, which cost equals labor plus the abstinence of the capitalist.[2] Abstinence is "a term by which we express the conduct of a person who either abstains from the unproductive use of what he can command, or designedly prefers the production of remote to that of immediate results." [3] In the formation of capital "some delay of enjoyment must in general have reserved it from unproductive use." This cost, then, as well as the sacrifice of labor, is an obstacle limiting production, and so, through supply, entering value.[4]

The significance of this new factor is apparent. Ricardo, with some misgivings, had in his formal writings left labor as the determinant of exchange value, profits being a sort of residual claimant. His followers, James Mill and M'Culloch, took the bull by the horns and expressly reduced all to labor, including even the growing value of wine or trees. Lauderdale had attacked the notion, making capital an independent factor which replaces labor rather than supports it; and Malthus made profits an independent cost along with wages. But there had been no analysis which would make capital coördinate with labor as a cost factor in production, and the labor theory was for the time dominant.

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[1] Above, p. 286.

[2] *Political Economy*, p. 24. Senior, however, confuses value of labor (wages) with labor pain, the latter being Ricardo's idea.

[3] *Ibid.*, p. 58.

[4] Böhm-Bawerk in his *Capital and Interest* (p. 285 of Smart's translation) accuses Senior of making his interest theory part of a theory of value in which he explains the value of goods by their costs; and concludes that as some goods are not reproduceable, it is but a partial theory. He overlooks Senior's express insistence on limitation of supply as distinguished from cost of production.

Senior may have caught the idea of abstinence from G. P. Scrope, who wrote three years prior to his article. Scrope states that the profit of the owner of capital is "a compensation to him for *abstaining for a time from the consumption* of that portion of his property on his personal gratification." [1] However that may be, the development and application of it are his own, and one of his chief claims to lasting fame rests on this basis which he laid for the independent determination of interest.

Cost *vs.* Expense; Past *vs.* Present Labor. — Such being the cost of production, according to Senior, it must be noted that he distinguishes "cost" from "expense," the former referring to "conduct," — "exertion" and "sacrifice," — the latter to the reward for such conduct in the shape of wages and profits.

Finally, Senior emphasized a point often thought of in connection with Jevons, and which was stated by Carey and Bastiat, namely, the fact that it is not *past* labor which enters into the determination of value; but that it is the amount of sacrifice that production would require *at the time of exchange.*[2] Ricardo and James Mill are criticized here.

Utility and Demand. — But Senior did not leave the demand side without adding something. Demand, he shows, rests on utility, or the "degree" in which a thing is desired. And he comes near to stating a law of diminishing utility. "Not only are there limits to the pleasures which commodities of any given class can afford, but the pleasure diminishes in a rapidly increasing ratio long before those limits are reached. Two articles of the same kind will seldom afford twice the pleasure of one, and still less will ten give five times the pleasure of two." [3]

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[1] *Principles of Political Economy deduced from the Natural Laws of Social Welfare and applied to the Present State of Britain*, p. 146 (London, 1833). Scrope lays great emphasis upon time.

[2] *Pol. Econ.*, p. 98. His statement is better than Jevons', as the latter writer confines himself to the negative part of it.

[3] *Ibid.*, p. 12.

Limitation of supply, however, remained with Senior the chief factor in value; and in stating the interrelation of demand and supply he says that the utility of or demand for a thing "is principally dependent on the obstacles which limit its supply."

Monopoly Theory. — Closely connected with the theory of value, is that of monopoly, and Senior's treatment of monopoly is notable.[1] He opposes the idea of monopoly strictly and logically to that of "equal competition": if every one has free and equal access to the factors of production, there is no monopoly; but wherever this is not true an element of it exists. Such is the case whenever land plays a part: commodities produced with the aid of natural agents are monopoly products, and the person who appropriates a natural agent is a monopolist.

Senior divides monopolies into four classes. First come those which are not exclusive, but exist because a producer has the advantage of lower costs, as, for example, Arkwright in producing yarn. This assumes the power to increase the product indefinitely. Secondly, there are absolute monopolies, where no increase in production is possible, as in the case of Constantia wine. The third case lies between these two, being an absolute monopoly, but one involving a product the supply of which can be increased. A copyright illustrates it. Finally, there is the "great monopoly of land." Here, as already suggested, the power of appropriation is limited and competition not equal.

Evidently several different points of view are involved in this classification. But a general solvent may be found in the idea of surplus value or, better still, in differential advantage. A feature common to all these classes of "monopoly" is the fact that income more than covers cost. Thus rent is a surplus above costs; hence Senior makes rent a monopoly return.

The weakness of defining monopoly in negative terms, as being the absence of equal competition, is apparent. Perfectly equal competition is rare, and elements of differential advantage abound on all hands, so that such a definition would make monopoly the rule. The essential error of Senior's position, however, lies in the confusion of differential advantage with control over supply. The one is price-determined; the other price-determining.

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[1] See Ely, *Senior's Theory of Monopoly*, Amer. Econ. Assoc. Pubs., February, 1900.

Theory of Wages. — In his theory of wages, Senior's treatment is characteristic. Some suggestive analyses and distinctions are made, and the problem is clearly stated; but, after much digression, we are taken little further than the statement that the proximate determination of wages depends on "the extent of the fund for the maintenance of labourers, compared with the number of labourers to be maintained." With these words, Senior probably called into being the wages-fund doctrine which lies concealed in the writings of Smith and Ricardo.[1]

Increasing Returns. — Senior was, on the whole, an optimist, and this shows itself in his doctrine concerning increasing returns from manufacturing.[2] His third postulate was that labor and capital may be indefinitely increased in productivity by using their products as the means of further production. He says, "Every increase in the number of manufacturing labourers is accompanied, not merely by a corresponding, but by an increased productive power." There is a "less proportionate cost," — a "constantly increasing facility" in working up materials.

No explanation of this fact is given, however, and Senior contents himself with citing decreased prices for manufactures. Though he does not make the point, his discussion of division of labor and capital in the same section suggests some explanation. Thus the use of tools and machinery makes more power available, and gives indefinite possibilities of improvement.

According to Senior, two results flow from increasing returns in manufactures. (1) An increased demand brings lower prices. With a rise in demand, the price of bread would rise; but under similar circumstances the price of lace would fall, improved manufacturing processes being made available. (2) A tax on manufactures, by decreasing the demand and the output, raises prices by an amount greater than that of the tax.

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[1] *Pol. Econ.*, pp. 154, 174, 195 f. For discussion see Cannan, *Production and Distribution*, pp. 267 ff.; Taussig, *Wages and Capital*, pp. 197–203.

[2] Ely, *Senior's Theory of Monopoly*, pp. 74, 83, 86, 119.

Emphasis on the Subjective. — One of the most striking general impressions that the careful reader of Senior gets, is the emphasis that he puts upon the subjective element. In this, he differs from most of his predecessors. This is seen in the relatively greater importance he attaches to utility. It shows itself in his inclusion of personal elements in capital. But chiefly it appears in his treatment of costs. His was a cost theory of value, but his costs were psychical and subjective; [1] consisting as they did of the laborer's sacrifices and the abstinence of capitalists.

Senior also further developed the Ricardian theory of foreign trade.

Critical Estimate. — In criticism of Senior's work, it may be truly said that it shows lack of constructive power, and even of intellectual endurance. His critical powers were remarkable. His logical and keenly analytical mind tears down, and then — we are disappointed. He is on the verge of great truths, but does not grasp them. Thus he formulates no law of monopoly price, nor does he realize the significance of a law of increasing returns. He does not grasp the concept of final or marginal utility. He does not give us a valid theory of wages. Yet in all these matters he makes more or less definite suggestions. He discusses capital instruments and the technical aid they give in production; but he lapses into the treatment of "capital" as consisting of "advances" to labor.

Among his more positive errors, the following only will be remarked upon, namely, the limitation of his first premise, which serves to bring into prominence the unduly abstract character of much of the Classical political economy; the uncoördinated character of his classification of the factors of production — land, labor, abstinence; his suggestion that the difference between rent and profits ceases when capital goods become the property of another than the abstainer;[1] and his inconsistency in treating the relative amounts of the social product received by the factors of production, — making the rate of profit a cause determining capital's share, for example.[2] His definition of monopoly has proved to be inexpedient.

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[1] Though he says (p. 112) that we seldom go farther back than the manufacturer's expenses.

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[1] *Pol. Econ.*, p. 129.

[2] Also the period during which capital is advanced is made another cause, yet this period is stated to depend in part upon the rate of profit. Inconsistency is also shown in statements as to the relative importance of the rent share.

b. The Expositors of the English Classical Political Economy Outside of England: 1776–1850

CHAPTER XVII

SAY, RAU, AND OTHER CHIEF EXPOSITORS IN GERMANY AND FRANCE

It is the purpose of this and the following chapter to give some account of the more important of those economists in Germany and France who, on the whole, may be classed as followers of Adam Smith. The point is that in the more essential matters they accepted the lead of the early British economists, and especially of Adam Smith. It may well be observed in advance that the Continental economists have frequently gone directly back to Smith, while rejecting in whole or in part the development of English thought by Ricardo and his group. Without making a sub-classification, it may be remarked that some of those to be mentioned showed considerable originality in exposition or criticism; a few even made additions to the Smithian economics. Among the following authors may be found men whose sound understanding and solid merit were greater than those of some to whom more distinct attention has been devoted, the reason for such attention lying in the novelty or influence of their views.

I. GERMANY

The close of the eighteenth century, as already indicated, found German economic thought under control by the professors of Kameralistic sciences. The Physiocrats had made some few converts, and the great upheavals of the time were not without influence; but it remained for Adam Smith's teaching to give the great impulse to a new and more scientific concept of economics.

It was not until the year 1794, when the first good translation of the *Wealth of Nations* by Garve appeared, that Smith's work was much known; and even in 1796 Sartorius complained, in the introduction to his *Handbuch,* that Smith had exerted but little influence. But shortly after 1800 all this was changed, and for a generation or more, English political economy was decidedly influential, if not dominant.

The German economists who wrote between 1800 and the rise of the Historical School, about the middle of the century, fall into three groups: the strict adherents of Smith; those who followed him to a greater or less extent, but with independent criticism; and those who were more fundamentally opposed. The last group will be discussed when Smith's opponents and critics are taken up.[1] As between the first two groups, it is difficult in some cases to place a man; but, taking everything into consideration it may be said that Kraus (1753–1807), Sartorius (1766–1828), Lüder (1760–1819), Hufeland (?) (1760–1817), and Lotz [2] (1770–1838) did little more than state Smith's case; while, on the whole, Soden (1754–1831), Jakob (1759–1827), Nebenius (1784–1857), J. H. von Thünen, and Rau (1792–1870) are the more important of those who followed, but criticized or supplemented in important ways.

It is beyond the scope of this chapter to give a detailed account of these writers, and differences among them make close generalization difficult. Thus Kraus, Soden, Hufeland, and Lotz followed Smith in their advocacy of free trade, while the others recognized national lines to some extent. Or, on the score of rent, only Jakob, Hufeland, and von Thünen showed much independence of the Classical doctrine.

Of the various economists just mentioned, the best known are doubtless Nebenius, von Thünen, and Rau.

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[1] Below, pp. 403 ff., 537 ff., 558 ff.

[2] Lotz shows some independence in treating value: *Revision der Grundbegriffe der Nationalwirtschaftslehre,* 1813, III, pp. 3–7.

Nebenius won fame with his work *Der Oeffentliche Credit* (Public Credit), published in 1820. Here he discussed the nature and function of capital, money, and credit, together with foreign exchange and public debts; and his contributions appear noteworthy. In general economic theory, his chief difference from Smith consisted in his belief in the expediency of more state intervention. He was active in promoting the German *Zollverein* (customs union), thus favoring a protective tariff. Nebenius, however, held Smith's ideas on productive labor, and he appears to have confused the problem of determining the relative shares of wages, profits, and rent with that of their absolute amounts.

Johann Heinrich von Thünen is but briefly mentioned here, for his thought forms the topic of the next chapter. His book, *Der Isolirte Staat* (The Isolated State), the first volume of which appeared in 1826, enriched German economic literature with one of its most original works. Through his brilliant deductions in the field of distribution, he worked out a consistent marginal productivity analysis of wages and interest, in addition to arriving at a rent theory similar to Ricardo's, with a more just emphasis of the situation factor.[1] Von Thünen's warm sympathy for labor led him to criticize Smith's theory of wages, emphasizing productivity and humanitarian considerations. In these matters, his views led him to favor a considerable degree of state activity in social reform.

Karl Heinrich Rau does not merit attention so much for original contribution to theory as for effective exposition. Through his *Lehrbuch der Politischen Oekonomie* (1826) [2] he had considerable influence not only in Germany, where it was the leading work during the second third of the nineteenth century, but abroad. It is encyclopedic, practical, and admirably adapted for the use of government officials. In an earlier writing, *Ansichten der Volkswirtschaft* (1821), he showed some appreciation of the historical viewpoint; but later reacted. His work is, in the main, little more than a compendium of current and preceding doctrines, enriched with historical, statistical, and technical information. It is a combination of Kameralistic erudition with the political economy of Adam Smith. This fact appears in the sub-divisions adopted: economic theory, economic policy, the science of finance.

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[1] Ricardo's work was not much known in Germany till after Baumstark's translation in 1837. Thünen, however, had read in Ricardo as early as 1826.

[2] The last edition prepared by Rau appeared in 1862–1868. Vol. I, *Grundsätze der Volkswirtschaftslehre*, 1868; Vol. II, *Grundsätze der Volkswirtschaftspolitik mit anhaltender Rücksicht auf bestehende Staatseinrichtungen*. 1862; Vol. III, *Grundsätze der Finanzwissenschaft*, 1864.

But this suggests Rau's solid merit. In his time, it was a service to stress as he did the distinction between theory or science and policy or art. Rau believed that the latter varies with local conditions; while the former is more exact and mathematical. Other merits are:[1] his well-balanced view of value in use and value in exchange; his distinction between concrete and abstract value in use; his attack upon the idea that the demand for labor depends upon the amount of capital.

A notable error which Rau, following Adam Smith, maintained, was his narrow notion of the productivity of labor: personal services he defined as unproductive.

Though, to the reproaches of Friedrich List, Rau made the claim that he had used the historical method, recognizing stages in economic development, he was quite far from the evolutionary spirit of the Historical School, his idea of stages being rather mechanical.[2]

The service rendered by the whole early group of German economists may be stated as follows: (1) The British emphasis upon labor was corrected by an insistence upon the importance of land as a factor in production; (2) subjective factors were given more attention, the productivity of labor apart from material objects being insisted on by some, and the significance of immaterial things, such as culture and morals, generally upheld; (3) ethics was taken into their point of view; and (4) a greater place was made for state activity, the individualistic teachings of the Classical economists being limited. Almost without exception, the German economists were influenced by Kameralism to the extent of recognizing the political duty of the state to take an important part in economic life for the sake of the common good.[1] (5) A step was also taken toward a separate analysis of entrepreneur's gains (Hufeland, Hermann, and Rau).

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[1] Roscher, *Geschichte d. Nationalökonomik*, p. 858.

[2] Similar objections might be made to similar claims set up by apologists of the Classical economists on the score of inductive method, appreciation of history, etc.

One notes a certain refreshing realism which is often found in the German writers, a fact that is no doubt due to the close connection between the German Universities and the state. To be sure, mere practical information may be associated with a lack of analysis or constructive power; but the leading German thinkers combined a wholesome practicality with a considerable amount of those qualities. The chief danger has lain in the possibility that the political aims of the sovereign may come to dominate scientific thought, that ethics may represent expediency, and that culture may cloak selfish ideals. It was on the whole unfortunate that economic science should ever have been so subordinated to political policy as it was in Germany during the greater part of the nineteenth century.

II. France

The rise of political economy in England took place at a period when the study of that science was declining in France. The eminent services of the Physiocrats have been referred to. But their influence, even in their own land, was never great, and they left no permanent school. Accordingly when, in 1779–1780, the *Wealth of Nations* was translated, it soon took the lead, easily overcoming the opposition of some surviving Mercantilists. The French writers showed less independence and originality than the Germans, a fact partly attributable, perhaps, to their slight interest in economics. But in the field of Socialistic propaganda they displayed considerable activity and originality.

The chief writer to be mentioned is Jean Baptiste Say (1767–

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[1] Br. Hildebrand, *Nat. Oek. der Gegenwart u. Zukunft*, s. 32.

1832), whose *Traité d'économie politique*, published in 1803, did more to spread Smith's teaching than any other work. Say was a business man and politician who was led to study political economy by a perusal of the *Wealth of Nations*, thereafter devoting much of his life to service as a teacher and author in this field.

The first of Say's contributions to be mentioned, and the most important, lies in the field of definition and arrangement. Perhaps through suggestion from Turgot's *Réflexions*, he divided the second edition of his treatise into books on Production, Distribution, and Consumption, thus originating an arrangement common in later textbooks. Exchange is not illogically treated under Production. Then he added to the idea that the national income falls into three shares — rent, wages, profits — so as to distinguish three corresponding factors of production in natural agents, labor, and capital. Furthermore, he somewhat developed the analysis of the part played by capital. And here it is noteworthy that he criticized English economics for combining the gains of the undertaker and of the capitalist.[1] He himself distinguished their functions, styling the former "entrepreneur," thus bringing into use a term which has found permanent place in the science.

In a broader way, he made some good suggestions favoring the use of the inductive method, and he argued that methods similar to those used in the natural sciences might be followed in political economy.[2]

The subject concerning which Say is best known, is his theory of markets (*Débouchés*).[3] He argues that the belief — held, for example, by Malthus and Sismondi — that there may be a general overproduction and glut, is an unsound generalization from particular experience. Generalized, there can be no such thing, for selling is at the same time buying, and in producing, men are creating a demand for other goods. And Say points out the bearing of this reasoning upon foreign trade: imports are no disadvantage, "for nothing can be bought from strangers, except with native products." As a matter of fact, there seems to be less merit in this idea, concerning which Say had exaggerated pretensions, than in some others; for it is but a little development over the Physiocratic teaching that, in buying and selling, goods exchange for goods. Say's argument is based upon the assumption that exchange is essentially "barter," but the use of money introduces lags and complications which make so simple and optimistic an analysis too unreal to be generally applicable.

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[1] Bk. II, Chap. VIII, § 2.

[2] See introduction to *Traité*.

[3] Bk. I, Chap. XV.

No account of Say's work would be complete without some mention of his position on value. In Book II, Chapter I, he shows his clear appreciation of the importance of the subject with relation to an understanding of Distribution. More than that, he puts the parts played by demand and supply in an advanced way, and gives more significance to utility than his English contemporaries. Utility is defined as the inherent capability of things to satisfy human wants, and value is said to originate in utility.[1] Price is the measure of value; value is the measure of utility, so long as the buyer pays no more than his estimation of the utility of his purchase. This makes room for costs, and Say slips over to the idea of normal value based on costs. He criticizes Smith's labor-cost theory, however, holding that "industrial" costs, including rent and profits, determine value. He also held that Smith had erred in narrowing economics by limiting wealth to material things: "He should, also, have included under it values which, although immaterial, are not less real, such as natural or acquired talents."[2]

Another point concerning which Say differed from his master was the greater extent to which he carried the *laisser-faire* doctrine. He would have allowed small place for state activity. The Frenchman was inclined to develop optimistic tendencies, and this is evidenced by his identification of public and private interests.

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[1] Bk. I, Chap. I.

[2] Introduction to *Traité;* also Bk. II, Chap. V, last paragraph.

In addition to enlarging upon consumption in general, Say deserves mention for his distinction between saving and unproductive consumption, and the discussion of their results.

Among the important criticisms of Say's thought are his lack of a broad historical training, his narrow — and jealous — criticisms of Ricardo, his excessive views on *laisser faire* and taxation, his belief that wealth consists in a sum of exchange values, and his insistence that from the social point of view gross and net revenue are the same. Shutting his eyes to real social costs, he held that "the term *net* produce applies only to the individual revenue of each separate producer . . .; but that the aggregate of individual revenue, the total revenue of the community, is equal to the gross produce of its land, capital, and industry." [1] The fundamental difficulty in Say's thought was a confusion between individual and social points of view. On the one hand, he treats costs as entrepreneur expenses, and wealth as exchangeable goods, both material and immaterial. On the other hand, he bases his whole analysis upon a conception of production, distribution, and consumption as social processes, processes which could be consistently applied only to social costs and material wealth.

The tendency has been to underestimate Say's services, perhaps because of his own exaggerated pretensions. He was no Smith or Ricardo; but he was no mere popularizer. His ability was not that of the masters, and may be called second rate, but such as it was, it was not small, as appears from the brief statement of his chief merits. The history of political economy would have been different without J. B. Say.

An excellent expositor of the Smith-Say doctrines was Joseph Garnier, whose chief work was done between 1848 and 1860.[2]

The only other French writers who fall within the province of this chapter are Cournot (1801–1877) and Dunoyer (1786–1862). Augustin Cournot has to his credit the first extensive and important use of mathematics in economics;[1] a method which, though it has resulted in no important discoveries, undoubtedly has its uses, especially in the concise and accurate presentation of deductions and the representation of slight variations. Thus Cournot was the pioneer in showing the relation between small increments in commodities and those in price. Cournot also attacked some of the optimistic notions of the French economists.

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[1] Bk. II, Chap. V.

[2] *Éléments de l'économie politique* (1848); *Traité de l'économie politique* (1860).

Even more clearly than Say, Charles Dunoyer was one of the followers of Smith who developed his optimistic tendencies.[2] By the close of the first quarter of the century, there came a group of Frenchmen who, while adhering to the most fundamental doctrines of Smith and Say, were more influenced by the social question which confronted them. This question was approached with some recognition of its ethics, but the tendency was to warn against government intervention and to advise free play for economic forces. Dunoyer may be taken as the chief representative.

Though not so clear-cut in his thought as Say, Dunoyer shows more independence. He lays greater stress than Say upon immaterial wealth, and he distinguishes production in which man himself is directly modified from production in which the immediate effect is the modification of some external object. In the former case, the physician, the artist, the teacher, and the clergyman work on man's body, imagination, intellect, and morals, respectively. Industries producing commodities are divided into the extractive industries, trade and transportation, manufactures, and agriculture. Mere exchange, not resulting in material things, is not included as an "industry," though its necessity is recognized.

Labor, Dunoyer thinks, is the only productive factor. Value measures services, things exchanging according to the quantity of services stored in them. This is coupled with the belief that nature's services are not gratuitous but are to be reckoned as costs. Payment for land is merely interest on capital. Bastiat, who, as has been seen, had similar ideas, was avowedly influenced by these views.

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[1] *Recherches sur les principes mathématiques de la théorie des richesses*, 1838.

[2] De Tracy (1823), Chevalier (1845–1850), and Garnier (1860) are others. See Kautz, *National-Oekonomik*, II, 571 ff. Dunoyer's chief works are: *De la liberté du travail* (1845); *Notices d'économie sociale* (1870, posthumous); *Nouveau traité d'économie sociale* (1830). On Dunoyer see Villey, *L'œuvre économique de Dunoyer* (Paris, 1899).

Dunoyer dwells on the part which the heedlessness and viciousness of the lower classes play in causing their ills; and, while laying part of the blame on society, argues for *laisser faire.* He believes inequalities are necessary and advantageous to society, but thinks they may be ameliorated; the initiative, however, should come from the sufferers themselves, as they know their own needs best.

The most notable tendencies, then, of the relatively few important expositors of the British political economy in France, were to take extreme views on *laisser faire,* and to be optimistic. Cournot was an uninfluential exception.

Closely related to the foregoing statement is the long-observed fact that French economic thought has been especially colored by a desire to defend existing social institutions against the attacks of the Socialists. Cairnes, writing in 1857, said of Say that

> "no one, I think, can peruse much of his writings without perceiving (and the same remark may be made of not a few French writers on Political Economy, and in particular of M. Bastiat) that his reasoning on economic problems is throughout carried on with a side glance at the prevalent socialistic doctrines. An inevitable consequence of this is — his object being quite as much to defend society and property against the attacks of their enemies as to elucidate the theory of wealth — that questions respecting the distribution of wealth are constantly confounded with the wholly different questions which the justification upon social grounds of existing institutions involves; and thus problems purely economic, come . . . to be complicated with considerations which are entirely foreign to their solution." (*Logical Method of Political Economy*, 2nd ed., p. 13.)

This fact helps to explain the tendency of French economists to treat rent, interest, and wages as being similarly determined shares, and their prevalent identification of rent and interest

CHAPTER XVIII

VON THÜNEN AND *THE ISOLATED STATE*[1]

Johann Heinrich von Thünen (1783–1850) was undoubtedly one of Germany's most brilliant theorists. Indeed, he may be compared to Ricardo in England, though his work was more technical and did not cover so important a part of the field of pure economic theory as money.

The first volume of his one work was published in 1826 at Hamburg, and had as its full title: *Der Isolirte Staat in Beziehung auf Landwirthschaft und Nationalökonomie, oder Untersuchungen über den Einfluss, den die Getreidepreise, der Reichtum des Bodens und die Abgaben auf den Ackerbau ausüben* [2] (The Isolated State in Relation to Agricultural and Political Economy, or Investigations concerning the Influence Which Grain Prices, the Richness of the Soil, and Taxes, Exert upon Tillage). The first part (*Abtheilung*) of the second volume (*Theil*) appeared in 1850; and not until 1863, long after von Thünen's death, was the work completed by the addition of a second part and the third volume. The whole work was printed as a third edition in 1875. It has been translated into French, and was finally honored by a place in a collection of the chief German economists.

In his general economic views, von Thünen may be classed as a follower of Adam Smith, of whose work he was a student. In his youth, he acquired a knowledge of practical agriculture, and afterwards studied what might be called agricultural economics under Thaer. Later his now celebrated estate (*Gut*) of Tellow was purchased, and here he made careful investigations of the same subject. Thus apparently if ever a man was thoroughly equipped for a practical work on the economics of agriculture, it was von Thünen.

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[1] As secondary references on von Thünen see Schumacher, *Johann Heinrich von Thünen, ein Forscherleben*, Rostock, 1868.

Büchler, M., *Johann Heinrich von Thünen und seine nationalökonomischen Hauptlehren*, Bern, 1907.

Helferich, "H. von Thünen," *Tübinger Zeitschrift f. Staatswissenschaft*, 1852.

Schneider, E., "Johann Heinrich von Thünen," *Econonometrica*, 1934.

Roscher's and Rambaud's histories of political economy.

[2] 2d ed. in 2 vol., 1842. The earlier page references refer to the first edition later ones are to the third edition, which contained his complete work.

Method and Plan of Work. — In dealing with von Thünen, the first thing that strikes one is his method. It appears in the very name of his book, the *Isolated State* — which he at first planned to call the *Ideal State.* Contrary to the usual procedure, then, the examination of this writer's thought will be begun with some discussion of his method of thinking. His method was a contribution. Indeed, the book is one of the best illustrations of the abstract-deductive or "exact" method to be found down to this very day. The first section of the first volume is headed "Postulates," the second, "The Problem"; then come various changes in the postulates, and finally a comparison of the isolated state with the actuality. It is the method of "successive approximations," which von Thünen explains is necessary in order to segregate and measure the influence of the particular forces in a complex.

Not only is the method abstract and deductive; it is characterized by a use of mathematical formulæ, these involving, however, only arithmetic or simple algebra. No use is made of geometrical figures. (It must be noted, however, that the later parts, which deal with labor, are not so purely abstract and deductive, and in dealing with the effects of climate, and the like, some modification of the method may be observed.)

It is von Thünen's plan first to reduce the problem stated in his title to its simplest elements. Accordingly, he says: Let us imagine a very great city set in the midst of a fruitful plain, through which no navigable river or canal doth flow. The plain itself consists of like land, which is everywhere equally adaptable to cultivation. Far removed from the city, the plain ends in an uncultivated waste which separates this state from the world without. There is no other city than the great one set in the center of the plain, and it furnishes all artificers' products, while the means of life are drawn entirely from the surrounding plain. Metals and salt are produced near the city (p. 1). "Now the question arises: how will agriculture shape itself under these conditions, and how will the greater or less distance from the city affect tillage if it is carried on with the greatest skill and care?"

Under these assumptions, the conclusion is drawn at once: "In general it is clear that in the vicinity of the city such products must be raised as have a great weight in proportion to their value (*Werth*) or are very bulky, and whose cost of transportation to the city would be so significant as to prevent their production in farther regions; so also with perishable products which must be fresh for use" (p. 2). Products of higher specific value would be drawn from greater distances. "On this ground alone, pretty sharply drawn concentric circles will be found about the city within which this or that crop will form the chief product." In the first circle, for example, garden truck and milk would be chief products.

In this circle, the land is the chief object of economy, while labor is relatively less important: "The price of milk must rise so high that the land for milk production can be of so much use through the production of no other thing. As the land rent (*Ackerpacht*) in this circle is very high, so increased labor is here little regarded. To gain the greatest amount of fodder from the smallest area is the problem" (p. 3).

The estate of Tellow is made the basis for the greater part of his calculations, its prices and expenses being taken for granted by von Thünen.[1] A large part of the book is a study of how the economy of this estate would vary with distance from the imaginary city and with changes in prices and taxes. It is assumed that the gross product may be estimated in grain and that the price of livestock will vary with the price of the grain, — which is really true, says von Thünen, of a state not surrounded by others which are uncultivated and merely engaged in grazing (p. 205). Further, it is assumed that the farm expenditures are made up of fixed percentages of money and of grain, this being done to simplify the determination of the effects caused by a change in grain prices.

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[1] Results obtained from records kept on his estate during the five years, 1810–1815.

All the various assumptions are adopted consciously, and the attempt is made to indicate what would be the result were they removed (p. 209 f.). As to equality of soil, he points out that one could also have assumed a fixed price for grain and various degrees of fertility in a second isolated state; but this is unnecessary, for formulæ already developed enable the solution of such problems as, for instance, what rent will a farm of any given productiveness yield when grain is worth a given price per bushel. As to water transportation, it merely operates to make points accessible to it virtually so much nearer the city by reducing freights. And, with numerous little towns, each must be thought of as possessing its contributory territory, thus making it necessary for the central city to draw its supplies from greater distances and so increasing transportation costs. The price of grain in the small towns would depend upon the market price in the capital city (p. 214).

While he did not fully realize the limitations of his method, von Thünen was partly aware of them. He wrote: "Just as a geometer reckons with points lacking in extension and planes without thickness, though neither actually exists; so we may take all adventitious circumstances and contingencies away from an active force, and only so can we recognize what share it has in the phenomena which lie before us" (p. 215). He believed that it would be possible to draw up a chart for an entire land indicating the circles of different products; but while the same principle which controls the industry of an isolated state would be at work, the actual phenomena, he saw, would be quite different on account of the "endless number of other relations and circumstances" (p. 215). In fact, von Thünen never overcame all the difficulties which beset the attempt to introduce the complexities of life into his abstract state.

Rent. — Von Thünen's work in the field of distribution is most interesting, and he naturally gives much attention to rent. In a section falling under the discussion of the three-field system and immediately following one on the determination of the price of grain, von Thünen treats of the origin of land rent (p. 181). The distant producer of rye, under the assumed conditions, must get 1½ thalers per bushel, for it costs him that much. On the other hand, the producer near the city could market his product for much less — perhaps ½ thaler; but the latter cannot be compelled to take a lower price than the former, nor can it be expected of him. For the buyer, one bushel has as much value (*Werth*) as another. What the near-by producer receives above cost is his gain. And "as this gain is permanent and returns yearly, so his land [*Grund und Boden*] yields an annual rent. The land rent of a farm arises, therefore, from the advantage which it has in its situation and in its soil over the worst farm which must produce in order to satisfy the demand" (p. 182). The value of this advantage expressed in money or grain, indicates the amount of the land rent. Rent is "the amount of the landlord's income which, after deducting interest on the value of the buildings, woods, and all valuable objects which can be separated from the land, remains and so belongs to the land as such" (p. 14).

In a note, von Thünen intimates that other investigations, which he does not report, show that there are other grounds for rent, — that even lands of equal fertility and situation with regard to market can, when completely distributed, yield a rent (p. 182).

It must be admitted that, while the significance of rent as a share in distribution is by no means so clearly indicated as is the case with Ricardo, this explanation of rent as such is clearer and more comprehensive than the latter's. If anything, von Thünen goes to an extreme opposite to that found in Ricardo's theory, in that he emphasizes situation rather than fertility; and his statement is thus a valuable corrective of the Ricardian formulation.

In a concluding section on Taxes upon Land Rent (p. 276) there is an excellent statement of the effects of taxation, improvements, etc., upon rent. The fact that rent is no fixed amount, but varies with prices and interest rate, is emphasized.

It is interesting to observe that von Thünen is not one of those who would minimize or overlook the difference between agriculture and manufactures, and so between rent and interest. "Agriculture," he writes, "differs essentially from industry (*Gewerke*) in that, when pursued on different kinds of soil, the same human activity is rewarded by very different production, whereas in industry the same activity and skill ever afford a similar labor product" (p. 271).

Price and Value. — Starting with the assumption that it costs the equivalent of 1½ thalers to produce and transport a bushel of rye from the most distant circle, von Thünen supposes a fall in price to 1 thaler (p. 177). Then the 1½ thaler land would cease to send grain to the city, including all land over 23½ miles away. Assuming the same population and demand, there would be a great lack of grain, and the price would at once rise: the price of 1 thaler is impossible. The following "law" is then deduced: "the price of grain must be so high that rent will not fall below zero upon the land on which the production of grain for the market is most costly, yet whose cultivation is necessary for the satisfaction of the demand" (p. 179).

Another interesting point concerns the determination of the price of the products of labor on the farm (p. 207). This must cover the outlays for food, etc., during the process, and for raw materials. If these materials must be procured from the city, the price of the product is only to a small extent determined by the local price of grain; but if the raw material — say flax — is produced on the farm, the price of the produced linen is largely determined by grain prices, since only a few articles for his home must be brought from the city and paid for by the farmer in money.

The place of demand is sufficiently emphasized, though not one-sidedly. If the consumption and demand increase, the price rises, and further cultivation "intensive and extensive" (p. 180) is the result. "As soon as this happens, production and consumption are again brought into equilibrium." Considering long-time periods, consumption is related to income: with equal production the rise or fall of grain prices will depend upon the increase or decrease of the income which the consuming class of citizens enjoy.

Finally the distinction between market price and average (*mittel*) price is made. Market price rarely, if ever, coincides with the average price, but constantly fluctuates about it. It is observed that the *Mittelpreis* alone has been the object of the investigation, the long-time point of view being taken. Evidently the concept is similar to that of "natural value." Smith's distinction between value in use and value in exchange is also followed (pp. 24, 128, 129).

Wages and Interest: Surplus. — Von Thünen was seriously concerned over what we call "the labor problem," and to its solution he devoted a large part of his later study.[1] For over twenty years after the publication of his first volume in 1826, he centered his thought upon the relation between interest and wages, and particularly upon the relation between capital and the product of labor.

Putting the question, Are low wages "natural" or are they due to usurpation by capitalists? he answers, The latter. What, then, is the natural wage? That is, what ought wages to be? Here, he says, the economists do not help us to an answer. They merely state a truism: wages are determined by demand and supply, and are what they are. This does not satisfy one who, like von Thünen, sees in wages the means of livelihood for men and women rather than a mere price set by competition upon the commodity, labor.[2] He says that Smith had done well for his time, but that, in view of the discontent and danger of class conflict which had since arisen, economists must go further.

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[1] See II Theil, 1 Abtheilung, 1 Abschnitt. He was well acquainted with Malthus' work on population.

[2] Thünen states that these ideas came to him in 1826 after reading in Say and Ricardo, and were written then, but not published, because they seemed too radical at that time.

Von Thünen, accordingly, seeks to get at the bottom of the problem by first simplifying it. He goes to the margin of cultivation, thus eliminating rent. He assumes a *tabula rasa.* He then reduces capital productivity to labor productivity. In so doing, he implies that capital is stored-up labor, his procedure being to divide laborers into two classes, (1) the capital-producing and (2) the mere subsistence-producing. He then proceeds to determine wages (and interest) for the first class, on the assumption that competition will give the same wage as to the latter class.

It is to be noted in advance that von Thünen had the idea that successive units of labor and capital yield less than proportionate returns, and that consequently there are surpluses above the returns on the last units, in which surpluses labor should share. The evil of low wages lies in the fact that capital retains more than its share. It is necessary, then, to ask: what is the natural interest rate, and can the existing rate be encroached upon?

Now with this idea in mind, and reasoning under the above assumptions, von Thünen seeks in four ways to analyze the relation between wages and interest, and to derive a law for determining the natural or proper wage (and interest): he considers (1) capital as produced by labor, or labor as producing capital; (2) labor as *replaced* by capital (i.e., substitution); (3) marginal productivity of capital; (4) marginal productivity of labor.

From the first point of view, he makes the interest on a given capital depend upon the amount of labor — or rather the amount of subsistence for labor — required for the production of that capital. The formula is: interest is to capital, as the (additional) income secured by the laborer as a result of his producing the capital is to the wages of the laborer. According to this idea, "natural" wages (and interest) would vary with productivity.

These conclusions must also apply to non-capital-producing laborers; otherwise they would take to producing capital. As von Thünen puts it, the excess of wages over subsistence must, at interest, equal the income secured by capital-producing laborers.[1] In a word, under von Thünen's assumptions, the additional income received by capital-producing laborers from the productivity of their capital would be a determining factor in all wages.

As to the third and fourth points of view, von Thünen's reasoning is based upon two advanced concepts: (1) a universalized law of diminishing returns; (2) a marginal productivity analysis of distribution. Briefly put, his idea on the third point is that as successive units of capital are added to a given industry or undertaking, the return diminishes in quantity and net value; that is, additional capital increases the productivity of a nation's labor at a lower rate than earlier portions. More definitely, successive units of capital added to a given amount of labor on marginal land result in a decreasing product per unit (p. 101), and the return upon the whole supply of capital, when lent, is determined by the use of the last bit of capital applied.[2] Thus, as already suggested, a surplus value arises in the use of the earlier units. This surplus above the marginal unit "naturally" belongs to labor.

From the fourth point of view, he considers wages as determined by the marginal productivity of labor. He illustrates by imagining additional labor put upon a given potato field, and presents a table indicating decreased returns. His conclusion is that the last laborer employed receives what he adds, and that his wage determines the rate for all laborers of equal skill and capacity.[3] From this point of view, there is also a surplus: "Even if the last-added laborers do not produce more than enough to cover their wages, yet the preceding laborers afford a very considerable surplus to the undertakers, which gives them the means of paying a higher wage." [4]

On all four bases, von Thünen professes to reach the same conclusion, namely, that the "natural wage" is indicated by the formula $\sqrt{AP}$, in which A equals the value of the product of labor and capital, and P equals the subsistence of the laborer and family.[1]

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[1] *Der Isolirte Staat*, 3d ed., pp. 150 f.

[2] *Ibid.*, pp. 99, 103.

[3] See *ibid.*, pp. 100, 178, 186.

[4] *Ibid.*, p. 187.

The general idea is clear. A surplus arises on the earlier units of an investment of successive increments of labor and capital. Subsistence must be considered as a minimum; but labor ought to have more than a bare subsistence, and ought to share in progress. How, then, shall this surplus be shared? Give labor a share which will vary as the square root of the joint product of the two factors. This would remove the fatal clash of interests between labor and capital, and as long as a laborer got such a wage he would never be in need, — a fact of "decisive importance" (p. 208). Needless to say, the above idea of margin and surplus anticipates ideas commonly associated with more recent developments in theory.[2]

In brief criticism, it must be remarked, however, that the foregoing idea of a surplus well illustrates a vicious tendency of the so-called "dosing method" of reasoning in economics. In reality, no such distinction between the value product of one group of laborers and that of another, increased by the addition of more laborers, exists. There is no such separation between the two cases as von Thünen's theory implies. One cannot logically assume that in the first case a group of men got certain wages, and then, when additional ones were employed and brought wages down, that the difference between the two wage rates would be left as a surplus in the hands of the employer. Rather the difference ceases to exist as soon as the new arrangement is effected, and the "surplus" is merely an historical thing. In the larger group, the laborers do not produce as much on the average as they did. Simply, conditions as to the relative proportions of land, labor, and capital have been altered, and, other things being equal, the average laborer is less productive.

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[1] He appears to have arrived at this formula in 1830.

[2] Professor Clark himself says: "With Von Thünen's work before us, no one else can claim as his own the application to labor and to capital of the principle of final valuation and the basing of valuation on productivity"; and goes on to indicate certain criticisms of von Thünen's thought in regard to which alone recent marginal-productivity theory is an advance. (*Distribution of Wealth*, p. 324, note.)

To his wages formula, von Thünen attached an exaggerated significance, even expressing a wish that it should be engraved upon his tombstone, though his correspondence shows that in later years he felt the impossibility of applying it,[1] and for practical purposes he suggested the use of a sort of profit-sharing scheme.

In fact, the formula has no exact validity. So varied is the part played by labor, relatively to capital, in different industries or in different stages of the same industry, that no such formula can express the share of the total value product attributable to it in general. Here, at least, this great economist fell victim to his abstract method and his disposition to reduce economic principles to mathematical formulæ. His formula would do under certain limitations, as under an assumption of the dominance of economic motives, of free land, equal opportunity, no capitalist class and little capital, and equal laborers. But as a scientific law explaining the causation or governing the determination of wages, it has no general validity. At most, it can be taken to express the rather obvious truth that the wage ought to lie somewhere between subsistence and total product — or, perhaps, the hope that wages may be above "subsistence."

One cannot but be reminded of Ricardo's difficulties in dealing with different proportions of fixed and circulating capital in working out his attempt at a labor theory of value. In any such attempt, the proportions of labor and capital must be known, which is but another way of stating that capital is more than stored-up labor, as such. There is another element of cost, or time, involved, which makes the application of the labor-pain or labor-subsistence value solvent impossible. In this Senior was wiser than von Thünen.

But one must not forget the great truths which accompany the error. The emphasis of the humanitarian and ethical aspects of the labor problem, while not primarily an economic matter, is important for the application of theory. Von Thünen did well, too, in calling attention to the productivity aspect and in criticizing others for dealing only with subsistence and supply of labor.

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[1] Schumacher, *Ein Forscherleben*, p. 239.

The breadth of his thought is illustrated by another criticism which he incidentally passes upon the economists. These, he says, had written as though land were the only productive factor to be economized. While it is true that the total supply of land is limited in a sense, yet there are places where it is abundant and labor is scarce, as in North America. Economic theory should be broad enough to accommodate all relations. As already implied, von Thünen is the father of an idea of diminishing returns that is broad enough to be applied to all the factors.

Tariff, and Miscellaneous. — Like Adam Smith, von Thünen was on the whole a strong believer in free trade as a general proposition. He believed that tariff restrictions reduce the material wealth of both the strong manufacturing nation and the weaker producer of raw materials. This theorem he deduced by assuming his isolated state to be divided into two, following with an application of his deductions to the actualities. Such would be the gist of his idea as drawn from the first volume.

Later, however, his thought appears to have undergone some modification, for in the second part of the second volume his conclusion is not so simple,[1] though not changed as to general tendency. It may be conjectured as a strong probability that an acquaintance with List's writings was the occasion for this development. Von Thünen contrasts national and cosmopolitan points of view: the one considers relative strength, the other absolute; the one seeks the strength of the nation, the other the material well-being of the people. Under existing conditions, the former point of view may be a necessity. He inclines to hold that free trade cannot be preached as an absolute good. And, as he says: "So Adam Smith in defending free trade generally held the cosmopolitan standpoint; but there are places in his work which take a national standpoint, and consequently both opponents and followers can find support for their views." [1] Von Thünen's reasoning differed somewhat from List's in that he considered both agriculture and manufactures, though chiefly the former; while List's argument proceeded largely on the basis of manufactures.[2]

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[1] See II, ii, 4, 4 (pp. 83 ff.).

The assumption that each individual knows his own interest, and acts accordingly, is specifically made; and, moreover, some evidence of a tendency to believe optimistically in an economic harmony appears, for he says: "As from the interaction of all, each striving for his own rightly understood advantage, the law according to which the community acts, arises, so on the other hand must the advantage of the individuals be comprised in the observance of these laws."

Moreover, there is apparent a tendency to regard the laws of society as being the outcome of a divine plan, for "man is the tool in the hand of a higher power" unconsciously working out His great ends.

Conclusion. — The conclusion is, in brief, that J. H. von Thünen produced a masterly piece of deductive economic thought, based in part upon careful statistical investigation; and independently developed the law of rent in an admirably clear fashion. He was the first economist to treat clearly and systematically of the influence of distance from the market upon the economics of agriculture. His method of approaching the price-determination problem plainly suggests the Austrian School's procedure; and the marginal productivity idea is clearly put, — though it is correctly connected with cost.[3] Probably his chief claim to greatness as an economist lies in his development of the marginal analysis in determining wages and interest, and his accompanying experiments with the method of "imputation."

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[1] *Ibid.*, p. 85.

[2] This point is put somewhat too strongly by Büchler, *Von Thünen.*

[3] 1st ed., p. 253.

III. OPPONENTS AND LEADING CRITICS

A majority of the preceding economists who have been classed as Smith's followers, now and then took occasion to criticize their master as well as each other. On certain points Malthus criticizes Ricardo, and Ricardo assails the logic of Malthus, while both find imperfections in the *Wealth of Nations.* Such men, too, as Senior and von Thünen were independent to a considerable degree, and did not fail to point out weak spots in the Classical economics. We have noted that several proposed revisions, and some even added new doctrines which survived and became part of the Classical scheme. Yet they all wrote within the framework of its doctrines as laid down by Smith and Ricardo, on the whole accepting the typical theories of production, value and distribution, and free trade. Whether tending toward pessimism or optimism, believing in this particular modification or that, the foregoing economists have been, for the most part, at bottom in accord with the doctrines of the English Classical School.

It is no simple matter to classify those who, on the other hand, opposed the Classical economics, or who criticized it in so fundamental a manner as to make it illogical to range them among the followers. By no means all of the critics are to be discussed; but only those whose criticisms seem the most fundamental, and whose influence has also been considerable. These have been divided into three groups: (1) those whose thought was based upon a *philosophy* which was opposed to the underlying system of the Classicists, (2) those who are most notable for their criticisms of the *method* of reasoning pursued or of the *scope* given the science, and (3) those whose chief criticism concerns the *logic* of the economic theories, regardless of philosophy or method. In other words, there were some who directed their assault upon its fundamental assumptions, opposing its underlying philosophy and its ethical basis. Others centered their attention upon the breadth of the ground covered or the method pursued by the Classicists, criticizing their definitions and logical *processes*. Still others cared relatively little about philosophy or method in themselves, but attacked the conclusions reached as being illogical.

Of course, the groupings proposed under such a classification cannot be all-inclusive and exclusive, and, needless to say, some critics opposed Smith and his followers on all three grounds. Just as philosophy and method are related, so the thinkers who criticize the logical method of the older economists are apt also to be at variance with them in underlying philosophy. Many criticisms of the logic of the Classical theories were made by economists placed under one of the first two heads. Nevertheless it seems desirable to distinguish these groups, emphasizing the main characteristics. It is generally possible to say that this or that opponent or critic directed his attention chiefly to one or the other of these three phases of thought. Generally one of the above points of attack is hit the hardest. At the least, this procedure will lead to a clearer understanding of the weaknesses of the Classical economics and to a better appreciation of the several groups of opponents.

1. THE PHILOSOPHICAL AND ETHICAL SYSTEM

One of the earliest and most frequent grounds of criticism has been the general underlying philosophy of the economics of Smith and his followers. This philosophy tended toward materialism, individualism, and utilitarianism of a hedonistic sort. It tended to leave ethical factors out of consideration, and to shun ethical responsibility; to make self-interest its sole basis and to recognize little or no good in government interference with industry; to assume that humanity consists of "economic men" who determine courses of action by balancing pleasures against pains in order to ascertain maximum net utility. It had the idea of an unlimited possibility of expansion in wants, and of an indefinite sum of satisfactions. Furthermore, there was a tendency to regard men as being equal by nature, and consequently the idea of cosmopolitanism came easily. Men being naturally pretty much equal, actual differences were considered to be due to environment — chiefly the material environment: this was a part of the materialistic tendency.

Of course, all the followers of Adam Smith did not show all these tendencies. They varied in the number of the tendencies exhibited, and the degree in which they were emphasized. Taken together, however, these tendencies form a closely connected group; and the foregoing paragraphs, together with the sections on philosophy and method in the preceding chapters, will give a sufficiently clear idea of that which the following thinkers attacked.

a. Individualistic Critics

The relation of the individual to the state has from the beginning been a chief point of dispute in economic thought. The social philosophy of the Physiocrats and Adam Smith, on the whole, was founded on individualism and led to *laisser faire.* It was based upon the assumption that the economic interests of individuals and nations are materially the same. One of the earliest attacks upon their system centered upon this idea.

It is interesting, however, to observe that several different points of view were taken by those who opposed that philosophy, some rejecting it in part, others in its entirety. Thus the least radical group accepted the individualism, but sought to make it more humanitarian by limiting *laisser faire*, being as a rule less optimistic, or careless, than the Classicists proper. There was, then, an individualistic criticism.

Others rejected individualism, and while they did not go so far as to advocate a socialization of property, they emphasized the nation as an economic unit, favoring more or less government interference with individual initiative in industry for national ends. These were nationalists in their criticism. They opposed that part of the individualistic tendency which leads to cosmopolitanism, regarding men as world citizens.

Finally, the Socialists must be noted among the opponents and critics, along with the individualists and nationalists. They have been the most radical of all, though the prevalence of misinterpretation and inconsistency sometimes makes Socialism seem quite in harmony with certain points in the philosophy and doctrine of the economists. Socialism, however, is the antithesis of individualism, and it must logically ever tend toward idealism in philosophy; while thoroughgoing Socialists have always opposed the most fundamental postulates of economics as developed from the doctrines of Smith and Ricardo.

First, then, let us consider those critics who on the whole accepted, at least tacitly, an individualistic basis for economic thought.

CHAPTER XIX

LAUDERDALE AND RAE AS INDIVIDUALISTIC CRITICS: SOCIAL AND INDIVIDUAL WEALTH

Lauderdale. — Early in the nineteenth century, two shrewd and eccentric Scotchmen wrote books in which they opposed Smith's economic system in a fundamental way. While accepting his individualistic point of view, they took the *Wealth of Nations* to task on the ground that it confused public and private wealth.

The first of these was Lord Lauderdale (1759–1830), who in 1804 published his *Inquiry into the Nature and Origin of Public Wealth and into the Nature and Causes of Its Increase.* French and German translations of this work appeared in 1808, and an enlarged English edition in 1819. Its main points concern value, wealth, and capital, in treating all of which the author showed much originality, and had a very considerable effect. More will be said of his ideas on value and capital in other chapters.

At the very outset, he emphasizes the importance of defining terms and analyzing their meaning; and he particularly stresses the distinction between "wealth" and "riches." The latter term he uses to designate private wealth. The former consists of "all that man desires, as useful or delightful to him" (p. 56).

Then, in his chapter on public wealth and private riches (pp. 43 ff.), Lauderdale begins by stating that all previous writers had made the mistake of confusing individual and national wealth, and had accordingly made national wealth equal the sum of individual riches. With such an idea, these writers had naturally reasoned that the proper way to increase national wealth is by means of "parsimony" (saving); for that is the means by which individuals become rich.

But here Lauderdale points to the fact that the riches of the individual depend in part upon the scarcity of the things saved, or, as we would say, an individual's wealth is the exchange value of his property. And he asks, does not common sense revolt against the idea of increasing wealth by making things scarce? "For example," he says, "let us suppose a country possessing abundance of the necessaries and conveniences of life, and universally accommodated with the purest streams of water: what opinion would be entertained of the understanding of a man, who, as the means of increasing the wealth of such a country, should propose to create a scarcity of water, the abundance of which was deservedly considered as one of the greatest blessings incident to the community? It is certain, however, that such a projection would, by this means, succeed in increasing the mass of individual riches; for to the water, which would still retain the quality of being useful and desirable, he would add the circumstance of existing in scarcity, . . . and thus the individual riches of the country would be increased in a sum equal to the value of the fee-simple of all the wells" (pp. 44–45). Or, in the case of food, to increase the supply would act *vice versa*. Or, again, would the declaration of a war which decreased the capital value of the national debt, rents, and other incomes, and so reduced private riches, decrease the lands, or waters, or any of the wealth of the nation? Surely not.

He concludes that it is very important to observe that in proportion as the riches of individuals are increased by an augmentation of the value of any commodity, the wealth of the nation is generally diminished (p. 50). This strongly suggests opposition between public and private interests. Indeed, he remarks: " . . . nothing but the impossibility of general combination protects the public wealth against the rapacity of private avarice" (p. 54).

In following chapters, Lauderdale treats of the source of wealth and the means of augmenting it, criticizing Smith vigorously on such points as non-productive labor, division of labor, and the function of capital. He concludes that wealth can be increased only by the means which produced it, namely, production by land, labor, and capital; parsimony,[1] or the "baneful passion of accumulation," cannot avail.

This doctrine finds expression in the extreme conclusion that the best way to increase public wealth is to make great expenditures, while the quickest way to diminish it is to accumulate a sinking fund.

In his discussion of "accumulation" and consumption, he may be dubbed the father of the idea [2] of overproduction based upon underconsumption.

Lauderdale's emphasis of consumption and demand, and his shrewd observations on the effects of varying distribution of wealth, are remarkable. He was far in advance of his contemporaries in these matters.

It is to be noted, too, that his treatment of capital anticipates the later development of economic thought, since he regards it as a factor coördinate with land and labor, which contributes to production by saving labor or by enabling man to do things beyond the reach of personal exertion. This is in advance of Smith's conception, but the thought is warped by Lauderdale's emphasis of oversaving and the fancied evil of having a nation overequipped with capital goods.

The breadth of Lauderdale's reading is notable, as he cites Xenophon, Locke, Petty, Vauban, Gregory King, Harris, Hume, "the works of all the Economists" (Physiocrats), William Pulteney, Hooke, Smith, Malthus, and others.

To Americans, at least, it is of interest to note that an early economist of the United States, Daniel Raymond (1820), refers to Lauderdale, and virtually follows him in contrasting social with individual wealth,[3] and the French economist, Ganilh, who was influenced by Lauderdale, in turn exerted an influence upon Raymond and other Americans. Indeed, the French translation had considerable effect in the land of the Physiocrats. In Germany, one of the chief economists influenced by him was

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[1] Considered as a national policy, not world-wide. See p. 266.

[2] See below, p. 395.

[3] Cf. above, pp. 317 f.

Hermann. One of the many writers of the early nineteenth century who read and were influenced by Lauderdale was John Rae, concerning whom a word must be said next.

John Rae. — The American writer, John Rae, furnishes another instance of early criticism of Smith's economics which should not be forgotten. Rae was a Scotch immigrant, first to Canada and later to the United States. His book was published in 1834 at Boston, Massachusetts, and was entitled, *Statement of Some New Principles on the Subject of Political Economy, Exposing the Fallacies of the System of Free Trade, and of Some Other Doctrines Maintained in the Wealth of Nations.*[1] While the title perhaps unduly emphasizes the merely critical part of the work, it sufficiently suggests the reason for presenting a brief treatment of its author at this point.

The first book of the *New Principles* is headed, "Individual and National Interests are not Identical." Rae adopts Lauderdale's general idea of a difference between public and individual interests, and develops a theory of government interference in harmony with it. His idea differs from Lauderdale's, however, in that he does not consider a difference in the wealth itself, but one in the "*causes* giving rise to individual and national wealth." His treatment is diffuse and lacks the verve and acumen of Lauderdale's thought; but it is his merit that he clearly shows how fundamental to Smith's thought is the notion of an identity between national and individual wealth, and that he connects his analysis with public policy.

Rae states Smith's case thus: "The axiom which he brings forward, that the capital of a society is the same with that of all the individuals who compose it, being granted, it follows that to increase the capitals of all the individuals in a society is to increase the general capital of the society. It seems, therefore, also to follow that as every man is best judge of his own business and of the modes in which his own capital may be augmented, so to prevent him from adopting these modes is to obstruct him in his efforts to increase his own capital, and . . . to check the increase of . . . general capital; and hence, that, as all laws for the regulation of commerce are in fact means by which the legislator prevents individuals conducting their business as they themselves would deem best, they must operate prejudicially on the increase of individual and so of general wealth." [1] Furthermore, Rae points out that it is assumed by Smith that as the capital of a single individual grows through saving and accumulation, so the national capital is increased in the same way.

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[1] Rae's work has been rearranged and edited by Dr. C. W. Mixter, and reprinted under the title, *The Sociological Theory of Capital.* (New York, 1905.) This reprint contains a biographical sketch and notes by the editor.

The whole scheme Rae rejects. In the first place, even assuming that individual and social interests are the same, it is not true that saving from revenue is the sole means that an individual uses to increase capital. He must first gain his revenue, and thus the amount he can save depends partly on his talents and capacities. Moreover, the fact that an individual by gambling and tricky bargaining may gain wealth, shows that self-interest does not always lead to increased national wealth.[2]

But it is not true that social and individual interests are identical, nor that the causes giving rise to wealth are the same in the two cases. For, while it is generally true that an individual can find employment, and so obtain an income from which he can save, in the case of a nation the "materials on which the national industry may be employed are to be provided, and often are or may be wanting." [3] Individuals seem generally to grow rich by grasping a portion of existing wealth; nations, by the production of new wealth. "The two processes differ in this, that the one is *acquisition*, the other *creation*." [4]

Rae then goes on to argue that the creation of wealth depends upon invention, and national wealth can be increased only through the aid of the inventive faculty.[5] Thus the power of invention plays a leading part in his thought.

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[1] *The Sociological Theory of Capital*, Mixter ed., p. 380.

[2] *Ibid.*, p. 345.

[3] *Ibid.*. p. 381.

[4] *Ibid.*, p. 383.

[5] *Ibid.*, p. 386.

In this connection, it may be remarked that Rae also criticizes Smith's treatment of division of labor, holding that it springs from invention rather than the reverse, and hence is effect rather than cause of increased productivity. And, of course, there is an element of truth in this, for in reality the two are interrelated, each being now cause and now effect.

In harmony with the foregoing ideas, Rae opposed a strong tendency of the Classical School by holding that there is no presumption against governmental interference. From what has already been written, it is evident that he denies the existence of any presumption in favor of *laisser faire.* But elsewhere he approaches the question in a different way, centering his criticism largely on the distinction between natural and artificial. He says that society is natural, proceeding from the operation of natural forces, both subjective and objective. But the statesman cannot be separated from society, nor can the actions generated by him be called unnatural. Therefore, the interference of the legislator is natural, and, Rae thinks, often beneficial: legislation may promote intelligence and invention, and prevent dissipation of the community's funds.

Though criticism of method might more logically be reserved for later discussion, Rae's is so unique and so entwined with his criticism of the philosophy that it can hardly be passed over without a word here. Smith's method, Rae says, is not truly scientific, that is, inductive. There are two sorts of philosophy, he explains: one is explanatory and systematic, the other is inductive or scientific. The former seeks merely to explain phenomena, as does Smith, fitting them into some machinery of "natural" assumptions. Furthermore, it generalizes from familiar and ill-defined notions, and the confusion in Smith's use of the terms, value, wealth, stock, capital, self-interest, desire of bettering one's condition, etc., is illustrative. The doubts and difficulties into which political economy has fallen since Smith's day are evidence of the weakness of his method. "If we, therefore, view his work as an attempt to establish a *science* of wealth, on the principle of the experimental or inductive philosophy, it is exposed to the censure of transgressing every rule of that philosophy."

Just what influence Rae exerted is not clear.[1] John Stuart Mill was acquainted with his book,[2] and it may be conjectured that some of his modifications of the Classical system were the result. An English economist, Hearn, who, as will be seen, had some influence on Jevons, also knew Rae's work. In 1856 an Italian translation was made.

Summary. — Both of the writers discussed in this chapter emphasized the distinction between social or national wealth and individual wealth, pointing to a lack of identity between public and private interests, and suggesting the advantage of considerable government interference. Rae, however, chiefly develops the idea of difference in the causes which increase the social and the individual wealth.

Both criticize Smith's emphasis of saving or parsimony, Lauderdale hitting it the harder of the two. (Both advocate spending.) Lauderdale emphasizes labor as the means of increasing wealth; Rae, the skill, dexterity, and direction of labor in *creating* wealth. The latter makes invention the main factor.

Both dwelt upon the total supply of capital instruments and the evils of a total overcapacity in these, failing to distinguish between (1) a general oversaving and (2) the misdirection of saving which may lead to overcapacity in particular industries.

Underlying their thought, both have the idea of a contrast between utility and exchange value, though this is far more marked in Lauderdale's case. It is interesting to note a similarity with the Physiocrats at this point. Lauderdale, indeed, says that the Physiocrats were nearer the truth in their ideas on "wealth" production than Smith; and Rae, in arguing that national wealth is increased only by *creating* new wealth, reminds one strongly of the *produit net.*

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[1] See Mixter's biographical sketch in *The Sociological Theory of Capital*, above cited, and the references it contains. For Rae's anticipation of important points in the theory of capital and interest, see *ibid.*

[2] Mill quotes Rae with approval in dealing with division of labor and motives for saving under the head of production. He also mentions Rae in connection with taxation.

It is easy enough, when one takes this tack, — and especially if ethical notions are mixed up with one's idea of utility, — to conceive of general overproduction. One then proceeds to define production so as to make it consist in the creation of goods which men "need" (not want), and in such quantities as are necessary, or "beneficial" to them. The existence of any quantity in excess of this ideal is termed overproduction. Accordingly, as already suggested, Lauderdale laid a basis for the ideas on overproduction for which two other economists with Physiocratic leanings, Malthus and Sismondi, are well known, and which crops out in more recent thought concerning business cycles, "welfare economics," and "the economy of abundance."

The notion that total saving may be carried too far, thus creating a general condition of underspending or underconsumption, and so causing apparent overproduction, has been one of the most persistent. To this day, it has been one of the chief grounds of "unorthodox" economic thought, since it is fundamentally opposed to the price system, or value economics. Its early formulation by Lauderdale and Rae, is, therefore, of more than passing interest.

These thinkers did well in opposing the extreme views of Adam Smith concerning the beneficent working of individual self-interest with reference to division of labor and saving. But they erred in plunging to the other extreme. They failed to comprehend the problem of balancing consumption and production, or cost and utility, and did not understand the part that objective value or price may play in maintaining such a balance. They do not appear to have understood that the problem of harmonizing "individual riches" and "public wealth" can be solved, if at all, only by some "socialistic" scheme of coercion or by the price system; and that an essential of the price system is a due regard for exchange value as the criterion of "wealth."

CHAPTER XX

SISMONDI: THE EMPHASIS ON INCOME AND CONSUMPTION

Among the earliest to revolt from the philosophy and ethics of the Classical economists was the French historian and writer on economics, Sismondi. This thinker well illustrates the difficulty of making a rigid threefold classification of opponents; for his criticism on the score of method is all but as important as his general revolt against the spirit of Smith's system, while he also attempted several criticisms of particular theories. Yet, after all, the notable thing about Sismondi is his ethical spirit and his rebellion against the underlying system. He desired considerable state regulation for social reform, but inasmuch as he did not advocate Socialism, he is to be classed as a limited individualist.

Life and Works.[1] — Jean Charles Leonard Simonde de Sismondi was born in Geneva, Switzerland, in 1773, only three years before the publication of the *Wealth of Nations*. His father, a Protestant clergyman whose ancestors had fled from France upon the revocation of the Edict of Nantes, had destined young Sismondi for business pursuits; but the boy was given a classical education, and this, together with experience as a minor government official, and travel through Germany and Italy, developed his taste and ability for historical and economic studies. He lived until 1842, and was the author of numerous works and articles in his chosen field.

Among his contemporaries were the economists, Malthus, Say, List, Ricardo, and Senior.

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[1] See *Political Economy and the Philosophy of Government, a series of Essays Selected from the works of M. de Sismondi*, by M. Mignet (London, 1847)· *Simonde de Sismondi as an Economist*, by Mao-Lan Tuan.

Thus Sismondi's life was cast among stirring events and great thinkers. The French Revolution, the Napoleonic wars, and the consummation of the Industrial Revolution and the factory system, were witnessed by him, and their attendant evils were noted.

A point which deserves comment here, is the divergence of effect produced in different minds by the French Revolution and related developments. The destruction of old institutions, and the change in ideas concerning government, were apparent to all. The individual, and his relation to the nation, took on a new significance. But the downfall of the "old order" brought opposite tendencies into play. (1) On the one hand, the Classical economists welcomed the end of Mercantilist regimentation, and demanded a policy of *laisser faire.* They dwelt upon individual "rights," and the motivation to production which individual initiative supplies, holding that self-interest leads to sufficient coöperation among individuals. (2) On the other hand, others soon came to demand the establishment of a new "order" to replace the old. They saw irreducible clashes of interest, and chaos, in *laisser faire.* Consequently, they demanded, if not a return to old forms of government, something that would directly take the place of the old regimentation. They saw the individual as a person needing protection. They emphasized duties, rather than rights. Security, rather than motivation to produce, came first in their minds. Conscious social planning and considerable government interference, seemed necessary.

Sismondi fell under the influence of the second of these opposing tendencies. He did not dream of reverting to Medievalism, as we shall find certain "nationalists" doing; he did not go so far as to demand the abolition of private property and the price system, as his "Socialist" contemporaries did; but he desired social planning and security by positive state action to minimize the uncertainties and instability of a competitive régime.

Sismondi's first economic writing was the *Tableau de l'agriculture Toscane* (1801), followed in 1803 by his more important work, *De la richesse commerciale ou principes de l'économie poli-*

tique, appliqués à la legislation du commerce. The *Richesse commerciale* treats of capital, price, and monopoly, closely following Adam Smith's ideas. If Sismondi had never written again upon political economy, he would have gone down in history with a bare word to the effect that he was among the minor earlier followers of Smith.

Then for a space of sixteen years important economic writing ceased. But history engaged his attention, and a close study of industrial phenomena around him. He observed the suffering and hardship which accompanied the close of the Napoleonic wars, and the extent and severity of the crises of 1815, 1818–1819, and 1825. He studied England, the land of industrial progress and political economy, and there he saw the rich growing richer while the poor grew poorer. He saw relative overproduction and unemployment; and he remarked, as he states in the preface of his next book, that the laborers, having become mere proletarians, cast off all restraint upon the size of their families. He saw danger, too, in the extended use of paper money and bank credit.

The book last referred to was his chief economic work, the *Nouveaux principes d'économie politique ou de la richesse dans ses rapports avec la population* (New Principles of Political Economy, or of Wealth in Its Relation to Population), which was published in 1819.[1] A second edition, considerably enlarged, appeared in 1827. In this new work, Sismondi presents a remarkable change of front. While still adhering to some of the main doctrines of Adam Smith and the Classical School, he draws radically different conclusions, and places the emphasis upon new matters. For Smith and his work, he professes admiration, and would even acknowledge his leadership; but he now seeks to complete and make new applications of his master's doctrines, and he sharply criticizes Say, Malthus, Ricardo, and M'Culloch.[2]

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[1] It resulted from and was based upon an article which he undertook to prepare for an encyclopedia.

[2] *Nouv. prin.*, Vol. I, Preface, and pp. 50–51. References are to the second edition.

It is interesting to remember that Sismondi was familiar with Italian thought, and it is probable that he was influenced by the Italian economist, Ortes,[1] who held similar views with regard to population and the distribution of wealth.

In his last important economic work, *Études sur l'économie politique* (1837–1838), his new ideas are reiterated: the economists, he states, had been swept off their feet by the spirit of industrial progress. He, however, had seen the suffering of society in an age of "progress" too clearly to go with them. Through observation and historical study, he had been led to abandon their conclusion.[2]

His Economic Thought. — a. *Scope of Economics and Criteria of Progress.* — In his outlook and purpose, Sismondi differed from the Classical School. He was a reformer. Ethical considerations played a large part in his thought; and to him economics was largely an art. He aimed to put economics upon a new basis: the economists had taught how to increase national *wealth:* he would teach how to increase national *happiness,* and to this end would point out the advantages of government intervention to regulate the progress of wealth.

Accordingly, his views concerning the scope of economics and the criteria of economic progress were at variance with the dominant theories. To Sismondi, enjoyment or happiness is the sole end of accumulation, and in it lies the true wealth of the nation.[3] And he criticizes the current emphasis on production, calling the Classical economics *chrématistique* (money-making science).[4] Consumption, then, plays a large part in his system; the history of all wealth is the same, — it is destined to yield enjoyments through its destruction or consumption.[5]

As limiting consumption, income, he says, rather than capital, is the important thing.[6] But, as in the "public fortune" the capital of one is the income of another, the economists have been embarrassed in deciding what is income and what capital, and have therefore left revenue out of consideration.[1]

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[1] *Economia nazionale* (1774).

[2] *Études,* II, 211.

[3] *Nouv. prin.,* Vol. I, p. 51.

[4] Cf. Aristotle's thought, above, pp. 63 f.

[5] *Nouv. prin.,* Vol. I, pp. 58 ff.

Neither material wealth nor population is an absolute sign of prosperity; that depends on the relation between the two. "Population is an advantage only when each man is sure of finding an honest living by labor." [2]

> "I have endeavored," writes Sismondi, "to establish . . . that to allow wealth to contribute to the well-being of all, as being the sign of all the material enjoyments of man, it is necessary that its increase should conform to the increase of population and that its distribution take place among that population in a proportion that can be disturbed only with extreme danger. I propose to show that it is necessary for the well-being of all that income increase with capital, that population do not exceed a living income, and that production be proportioned equally to capital which produced it and population which consumed it." [3]

b. *His Scheme of Distribution.* — According to these notions, Sismondi worked out a scheme of distribution which cannot but remind one of Quesnay's in its pretentiousness. As nearly as it can be reduced to exact statement, — for his terminology is vague and not free from inconsistency, — that scheme is as follows.[4] We begin with the annual *national revenue*, through which the population is to acquire its consumables. In this national revenue, two parts may be distinguished: (1) profits on capital and land, which, though distinct, may be classed together here; and (2) labor power.

Of these parts, the former, profits, is of the past. It is the result of the labor of the previous year, in the hands of consumers. Labor power, on the other hand, is future, as it were, only becoming wealth through opportunity and exchange. Labor acquires a new right each year by new labor; capital holds a permanent right based upon control of past labor. On the whole, there is an opposition of interests between the classes receiving the two shares; yet a certain relation exists between these shares in that they have the same origin.

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[1] *Ibid.*, p. 9, Preface. Note how he confuses thought by treating "capital" as coördinate with "income." He seems to have in mind "production" (or, perhaps 'saving") as opposed to "spending."

[2] *Ibid.*, Vol. I, p. 9.

[3] *Ibid.*, Preface, pp. x-xi.

[4] *Ibid.*, pp. 104 ff.

This national revenue is destined to be exchanged for the annual *national production* (of the ensuing year), to which it should be equal. The annual production likewise consists of profits and labor power.

The annual national production is, then, consumed annually, labor giving labor power in exchange (for its share), and capital giving of its revenue (or interest). The labor power, we are told, becomes converted into capital, and is then reproduced as is other capital. By this annual consumption, involving the exchange of one year's *revenue* for the *production* of the next, each maintains his consumption or replaces his capital.

If, therefore, true economy be used, and things go prosperously, the annual consumption will be exactly limited by the national revenue, and the total production will be consumed.[1] When this is not the case, it is obvious that the desired equilibrium is disturbed, and that either overproduction or underproduction must result. Equilibrium involves an exchange of all that is called capital for labor, the former apparently becoming the revenue of the labor class. Accordingly, if the "rich" spend so much as to consume their capital, the revenue of the poor for the following year is encroached upon, and in this case, saving (not spending) is required to maintain employment and keeps wages up. On the other hand, oversaving (underspending) would destroy the balance between annual production and consumption. Sismondi hardly considers the alternative of underproduction, for he is bent upon overthrowing the doctrines of the Classical political economy concerning the productivity of capital and division of labor.

Though arguing thus concerning an equilibrium of production and consumption, Sismondi did not advocate an absolute standstill or a perfect circle; rather he thought of a spiral brought about by a very gradual increase in production. Even this would cause small losses by disturbing the proper equilibrium, but they might be offset by future benefits.[1] A series of small losses coupled with increasing capital and public fortune, — in this consists national economy.

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[1] *Nouv. prin.*, Vol. I, p. 115.

In this general connection, Sismondi takes occasion to criticize "the economists." They had, he thought, confused past revenue with future revenue, and omitted to treat of consumption.[2] They had argued for an increase in labor as being possible and desirable as a first step, which would mean an increase in wealth, in revenue, and in consumption, respectively, consumption thus being placed last. But, Sismondi urges, it is more nearly correct to say that an increase in the demand for labor must come first: that is, increased revenue and consumption must precede the increase in labor and production. Accordingly, more wages would have to be paid, whereas wages are fixed in advance, being limited by preëxisting revenue.

c. *Overproduction and Machinery.* — Sismondi's whole scheme of distribution is underlain by an "unorthodox" belief as to the possibility of general overproduction, which militated against the success of his work. He argues that if the annual production were in excess of the annual revenue, which seemed to him quite possible, overproduction would be the result. Capital would then suffer loss, labor would go unemployed, and thus the consumers' gains through lower prices would be but temporary.[3]

In reality, there seem to have been two different notions of overproduction in Sismondi's mind: one concerned "use values" or total utility; the other, exchange values. It is not unlikely that he was confused in dealing with the two. His reasoning upon the former notion, which to him is the fundamental one, Sismondi appears to have based upon the need for "repose." [4] He states that repose, or rest, is a "natural" taste of man. It is the reward of labor. Man accumulates only to consume, which implies repose. But under the dominant system, laborers must work on, making a superabundance of products, many of which are luxuries. Their efforts are thus separated from their reward.

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[1] *Nouv. prin.*, Vol. I, p. 121.

[2] *Ibid.*, Vol. II, Chap. VI.

[3] *Ibid.*, Vol. I, pp. 118–119.

[4] See *ibid.*, Vol. II, Chap. III. Repose is partly defined as including change of activity from wealth creation to enjoyment and to intellectual and artistic development.

That a line drawn between necessities and luxuries, is also an essential part of Sismondi's reasoning here, is clear; for it is only for luxuries that man's wants are unlimited, and it is in multiplying goods beyond *needs* that overproduction lies. In a word, if men would satisfy their needs only, including the need of repose, the unremitting labor of the day would not be required. If the truth of his semi-ethical idea of necessities and luxuries be granted, as well as the statement that laborers are overworked, there is nothing inherently fallacious in the reasoning so far.

It is on the point of overproduction of exchange values that Sismondi falls into positive error. Here his whole idea is that an *increased demand must precede increased production*, and his criticism of the economists has already been referred to. He fails to see that, in the long run, production and revenue are interdependent; that production is the source of revenue; that it indirectly creates and directly limits "demand." He fails to see the significance of the fact that exchange values are relative, and that as a general proposition their total amount cannot be affected by changes in the total production of all commodities. Hence, he is led to uphold the possibility of a universal glut or general overproduction. Indeed, he states that at the time he wrote such a condition prevailed and had been in existence several years.[1]

While he calls attention to important truths, Sismondi's oversights and fallacies on this point are many. He fails to see the difference between consumption and "demand," or at least does not understand the significance of this difference; for he does not

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[1] See the article on "Balance des consommations avec les productions" appended to Tome II of the *Nouv. prin.*, pp. 379 ff. Here is found an interesting criticism of an article by M'Culloch which admirably illustrates Sismondi's method

allow for the fact that consumers must produce before their wants can become "effective." He generalizes too hastily from overproduction in particular industries. He illogically breaks into the round of production and consumption, and assumes revenue and demand almost as if they were something absolute, this being accentuated by his constant separation of the operations of one year from those of another, thus artificially chopping industrial life into segments. He ignores the decrease in costs which frequently attends increased production,[1] in this assuming a loss to capital and decreased employment, whereas decreased expenses of production would permit equal net earnings and increased employment. He, in his pessimism, does not consider facts as to increased consumption or as to its greater variety. And, finally, as a criticism of the Ricardian school, his arguments are weakened by not making due allowance for their assumptions [2] as to length of time, mobility, and economic motive.

But his truths are not to be forgotten. He justly criticized the economists for reasoning so abstractly as to overlook the delay and friction often involved in bringing supply and demand into equilibrium. To this element of friction, Sismondi constantly points. And not only is there the immediate lack of equilibrium; it is increased, and its evils are heightened, by the fact that laborers frequently must remain at work though wages are lowered and hours increased.[3] The force of habit, and the technical difficulties of transferring fixed capital, are brought into clear relief.

Sismondi attacked the prevailing idea that machinery is an unmixed good. Here again, though he goes too far, his criticism has its value. His real point is that invention and the introduction of machinery are an unmixed benefit only when preceded by an increase in revenue and demand which would allow the employment elsewhere of the labor which is displaced; otherwise there is suffering through lower wages and unemployment. All of which, for a given time, is frequently too true. Sismondi, however, would have restricted the adoption of machinery; while the economists, when they did not treat the question in such an abstract and general manner as to sail above it, would have resorted to some system of relief pending new adjustments.

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[1] E.g., in discussion in *Nouv. prin.*, I, pp. 118–119.

[2] While they, of course, are open to criticism for not keeping their assumptions duly to the front, and not limiting their conclusions duly.

[3] *Nouv. prin.*, Vol. I, p. 333; and Vol. II, pp. 379 ff.

d. *Population.* — As already indicated, Sismondi deemed the end of political economy to be the discovery of that proportion between population and wealth which would assure the highest well-being. He gives much attention, therefore, to population.[1] His thesis on this subject is that, while sympathy or the affections urge to marriage, egoism or calculation deter, and through the interplay of these forces population would naturally be regulated according to revenue.[2] Laborers, he thinks, do not naturally marry unless they have employment and an assured income. But industrial instability makes foresight vain, and the introduction of machinery causes unemployment. The evil situation arises in which the births of a nation exceed its revenues, and with overproduction, unequal property, and exploitation by the rich, revenue is encroached upon and wages are reduced. One of the points that Sismondi particularly mentions in his preface is the gloomy idea that the natural limits to population are always respected by those who have, while they are exceeded by those who have not.

Sismondi believes Malthus to be quite mistaken in his ideas on the natural limits of population. The real limit, he holds, lies in revenue. Population is not limited by the subsistence which land can produce, but is checked by inability to get work and wages before such a limit can be reached. In opposing the ideas of a geometric and an arithmetic progression, Malthus was contrasting a mere potentiality with an actuality. Nay, rather with less than the actuality, for the increase of plant and animal life is more rapid than that of man. And history is appealed to for the purpose of showing that nomadic peoples have restrained population while their land would have supported a much more numerous people.[1]

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[1] *Nouv. prin.*, Vol. II, book 7.

[2] See *ibid.*, Vol. II, pp. 253–255.

e. *Reforms Advocated.* — Sismondi recognizes a conflict between public and private interests, and so logically calls upon the state to interfere: first to adjust production to revenue or demand (population), and secondly to apply certain particular remedies directly. Thus he urges the restriction of inventions, and advocates steps toward giving some property to labor. In agriculture, small proprietors are favored; in manufactures, more small-scale industry and increased responsibility on the part of the employer.[2] Such responsibility, as for sickness, accident, old age, would give the laborer rights akin to those of property. In addition to all this, there are many vague appeals to statesmen to try to stay the struggle for increased industrial production. Under the head of more direct and less general reforms would fall his advocacy of regulation of hours, and of child labor; and of legislation giving laborers the right to combine.[3] In these matters, Sismondi's importance as an early thinker in the field of social reform will be recognized.

f. *Exploitation of Labor, and Socialism.* — Though he does not draw Socialistic conclusions, Sismondi's argument often runs like that of Marx himself, and his thought concerning the exploitation of labor undoubtedly influenced Socialistic criticism. Generally, though not with entire consistency, he states that labor is the source of wealth. The "rich" can only obtain the products of others' labor through exchange. If they were to spend their capital, they would become impoverished. But this is not necessary, for in the existing social order they make their property produce through the labor of others. In so many words, he says that capitalists exploit laborers, gaining not because they produce a surplus above costs, but because they pay less than cost.[1] At one point, the word "spoliation" is used.[2] Luxury is possible only where it is maintained with the labor of others; unremitting toil, only where it secures a bare subsistence, — this is a corollary of his ideas on overproduction.

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[1] Of course this fact is not necessarily in conflict with Malthus' theory, even as it is stated by Sismondi, for it may be subsistence which holds that population in check, whether gained by grazing or agriculture. In any case, the moral restraint idea is overlooked. For Malthus' reply, see his *Po' Econ.*, 2d ed., p. 366, note.

[2] E.g., *Nouv. prin.*, Vol. II, p. 661.

[3] E.g., *ibid.*, Vol. II, p. 451.

Competition is criticized as leading to overwork and to the employment of women. Government intervention is advocated. Yet Sismondi stops short of Socialism, and criticizes Owen and others.

Method. — A marked characteristic of Sismondi was his concrete and historical method. Smith and Malthus, he praises for their study of history and facts; while he constantly criticizes Ricardo for his abstraction and hasty generalization, and takes Say and M'Culloch to task on the same ground. Indeed, Sismondi was as much an historian as an economist. He was fully aware of the necessity for taking time and place and history into consideration. His best work lies in his concrete study of economic phenomena, and when he takes to abstract analysis he not infrequently falls into inconsistencies that confuse the reader.

Influence. — No evidence has been found that the German Historical School acknowledges a debt to Sismondi, yet it is probable that he was well known to the leaders of that school, — Roscher gives him favorable comment in his *History of Political Economy* in Germany, — and some small degree of influence seems not unlikely. More recently, in America, the so-called "institutional economists" profess to derive some aid and comfort from his example.

Aside from this, Sismondi's influence was chiefly felt by the Socialists. Indeed, he has sometimes been wrongly classed as one. Though his writing was thus effective along a line which he would not himself have followed, he was almost universally rejected by economists. This was no doubt due to the extremely reactionary character of his thought. He called for government intervention in an age of *laisser faire*. He was a pessimist in a land where optimism reigned. He opposed the very spirit of the dominant economics in his criticism of *chrématistique*, competition, etc. And his notions concerning overproduction and machinery were not only largely erroneous, but were peculiarly offensive to the "orthodox" English Classicist.

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[1] *Ibid.*, Vol. I, p. 92.

[2] *Études*, I, 274–275.

J. S. Mill read Sismondi, and his more humanitarian spirit and advocacy of government intervention, even passing over to Socialistic views in his later years, must have made him a sympathetic reader. But to what extent he drew on Sismondi cannot be stated. Fix, Droz (*Économie politique*, 1829), Villeneuve-Bargemont (*Économie politique chrétienne*, 1834), and Minghetti (*Della économia publica*, 1859) might be classed as followers; and Buret appears to have been a sole disciple.[1]

Conclusion. — In brief summary, it may be said that Sismondi stood for social security, and to that end advocated considerable social control over economic life. In this, he was opposed to "the price system," or exchange-value economics. He believed, however, in an equilibrium of economic forces, and sought to formulate the law thereof, thus setting up a claim to a position as a scientific economist. From the standpoint of economic doctrine, his chief characteristic is his attempt to break the circle of economic life by putting consumption first, and treating it as an absolute. Accordingly his thought is vitiated throughout by the doctrine of underconsumption, to which he ascribes economic disequilibria and crises. And accordingly, he sought to find the remedy for economic maladjustments by increasing consumption *relatively* to production, both by restricting production and by increasing the responsibilities of employers and landowners for the annual incomes of "dependents." He would have favored a considerable redistribution of wealth, but without any revolutionary change in existing institutions. Nor did he, in view of the monetary ills of his day, advocate inflation as a means of giving the poor more revenue. Sismondi was an historian turned social reformer. His economics was based upon an ethical ideal.

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[1] *La misère des classes laborieuses en Angleterre et en France*, 1841. See Gide-Rist, *Hist. des doctrines économiques*, p. 228.

b. Nationalistic Critics

CHAPTER XXI

MÜLLER, LIST, AND CAREY: THE EARLY NATIONALISTS

The Nationalists, the criticism of whose thought comes next, comprise a group of politico-economic writers of the early years of the nineteenth century, who attacked the individualistic-cosmopolitan, free-trade doctrines of the Classicists, and advocated policies designed to build up the productive powers of nations, without direct regard for individual wealth. The Classicists looked at the nation through the eyes of the individual, and regarded its wealth as the sum of individual wealths. The Nationalists saw individuals as dependent parts of the nation, and their wealths as both dependent upon and subordinate to the power and well-being of the whole.

The Nationalists and Their Background. — As the nineteenth century began, the difficulties of extreme individualism and *laisser faire* became apparent, not only in theory, but also in dealing with the practical problems of crises, unemployment, poverty, monetary manipulation, and war. The underlying assumptions of Classicism had led either to pessimism, or to a futile and unreal optimism. Accordingly, we find arising: (1) Liberal social reformers, who would have merely revised existing institutions in accord with a moderated individualism; (2) Socialists, who would have established new institutions and greater equality in distribution, and to that end would have abolished private property in large part; (3) Nationalists, who would have subordinated individuals to the state, which they regarded as the primary reality, for the purpose of organizing permanent inequalities among individuals, and increasing or coördinating the aggregate productive capacities of the whole.

Nationalism was fostered by inequality among nations, and throve in industrially backward countries which sought to build up their strength, both military and economic. Indeed, in some respects, it resembles Mercantilism. Nationalism, however, rests upon a more idealistic and purposive conception of the state as an organized whole. It is philosophically more sophisticated than Mercantilism. We have commented upon the recrudescence of Mercantilism which followed the World War and the ensuing great depression, and it should be noted here that in a good many respects this phase might better be described as "Nationalism." Fascist, Nazi, and even "New Deal" policies, all show signs of it. And just as early nineteenth-century Germany had her Fichte, Müller, and List, so early twentieth-century Germany has her Othmar Spann.

None of the early Nationalists were English. It is natural that this serious outbreak against the authority of Adam Smith should have taken place outside of Great Britain. Written for his own country and based upon the national life of his time, it was to be expected that the *Wealth of Nations* would answer the needs of England better and longer than those of other countries. It is natural, moreover, that what was perhaps the most thoroughgoing revolt against its teachings this side of Socialism, should have occurred in a land whose development and manner of production differed essentially from those of Smith's native country.

Germany, accordingly, has been one among the great civilized nations to lead the rebellion against English political economy. Many German thinkers felt that it did not meet her requirements, and from the earliest years of the nineteenth century her economists took a more nationalistic stand. Sartorius (1806), Jakob (1809), Rau (1826–1832), and Hermann (1832) may be mentioned as to a considerable extent recognizing national bounds in theory, and making some place for tariffs. (Excepting Hermann, however, these writers were essentially followers of Adam Smith, and nationalism was not the heart of their thought.)

Germany was not only backward in industrial development, and predominantly agricultural, but Germans were divided into numerous petty states whose clashing sovereignties prevented coöperation.

Then, too, there developed a characteristic German idealistic philosophy — an "objective idealism" which considered mind as the only reality. Immanuel Kant attacked empiricism and rationalism, and maintained the power of "moral self-determination." He argued that man's intuitions of time, space, quantity, etc., come from the spontaneous action of the ego.

Then J. H. Fichte (1794) sought to supplement Kant's thought by showing how such intuitions are derived from pure consciousness, stressing the freedom of the will and the moral aspects of human nature. He taught that individuals are not mere "atoms," but are organically interrelated parts of society and thus have no "natural rights." To more practical effect, in *Der geschlossene Handels-Staat* (1800) Fichte held that nations must be essentially independent, each supplying its own needs in so far as possible. Each nation should control its own economic life, and assign to its several "estates" or classes their respective functions. Foreign trade seemed to him to be apt to upset the internal balance.

Finally, there was the development of Romanticism, first in art and literature, but then in social thought. This is significant as being a revolt against most of what the French Revolution had stood for — the things that represented individualism and economic values determined by free exchange. It was a reaction against "Classicism" of all kinds! Both rules of art and "laws" of social science, were rejected. Self-expression was defended; but, in view of the evils and suffering of this world, the self seemed to require protection, so the Romanticists turned back toward Medievalism, and emphasized divine power — the eternal. Hence they were mystics. Competition — individual struggle — under *laisser faire* seemed hopeless. Hence they were sceptics.

With an industrial inferiority complex in their minds, and a yearning for a self-expression unfettered by objective realities or material limitations, these thinkers sought protection for the individual by making him part of a great national organism.

Obviously there would be those in the young American nation, with its industrial inferiority, its eager urge to self-expression, and its characteristic strain of idealism, who would readily fall in with similar ideas.

And, again, under somewhat similar conditions in the World War period, it is not surprising to find, one hundred years later, the same tendencies showing themselves both in Germany and the United States — the same rejection of "rugged individualism" and of laws of economics which assume free competition — the same doctrine that individual wealth is chiefly attributable to collective social processes — the same resort to a medieval-like regimentation and "allotment" of economic functions among classes and sections — the same "Nationalism."

While there is an inner unity of thought among all the Nationalists, we may distinguish two main groups: (1) The Romanticists, and philosophic Nationalists, of whom Müller is the most important; and (2) the Protectionists, among whom List is outstanding. The former are more philosophical, and more consistently idealistic. They are more given to the organismic concept of society, and to ideals of stability and permanence. The latter are more apt to stress tariff policies and industrial development. They are usually driven to accept some degree of individualism.

Adam Müller.[1] — The first to express this feeling of nationalistic revolt so as to attract considerable attention, were the political economists called, in Germany, Romanticists, of whom the leading representative was Adam Heinrich Müller, and the two other most prominent adherents, Friedrich Gentz and Karl Ludwig von Haller.[1] Gentz translated Burke's *Reflections* on the French Revolution, which work doubtless had its effect upon Müller. Franz von Baader is also to be mentioned as one who, as Spann puts it, held "a genuinely organic conception of economic life," and "refuted the atomistic and individualist economics of Adam Smith." [2]

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[1] For a sympathetic, even partisan, exposition of Müller's ideas, together with bibliography, see O. Spann's *History of Economics*, Chap. VIII.

Adam Müller was born June 3, 1779, in Berlin. In 1799, he went to the University of Göttingen, where he studied law. Upon his return to Berlin, he received a government appointment. Later he held various positions in Austria in what we would call the treasury department. His death occurred in 1829. While in Vienna, in 1805, he became a Roman Catholic, on which account he has been called a notorious apostate. Soon after this he went to Dresden and delivered lectures, which were published in that place in 1806, with the title, *Vorlesungen über die Deutsche Wissenschaft und Literatur* (Lectures on German Science and Literature). A second edition appeared in 1807. In these lectures he advocated what is called the *Schlegel'sche Romantik* — the romanticism of Schlegel.

His writings are often mystical, Catholic, and reactionary. Indeed, they represent the reaction which followed the French Revolution and the Napoleonic wars.[3]

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[1] Justus Möser preceded these men with similar ideas. But his work was not in criticism of Adam Smith. He was, however, opposed to the liberal, rationalistic spirit which led up to Smith's work. He was reactionary, favoring medieval institutions. See Roscher, *Gesch. d. Nationalökonomik in Deutschland.*

[2] Spann, O., *History of Economics*, p. 170. Baader wrote *Ueber das dermalige Misverhältnis der Vermögenslosen oder Proletairs zu den Vermögen besitzenden Klassen der Sozietät*, 1835.

[3] The most prominent are:—

Von der Idee des Staats, Dresden, 1809.

Die Elemente der Staatskunst (The Elements of Politics), Berlin, 1809.

Die Theorie der Staatshaushaltung (The Management of State Finances), Vienna, 1812.

Versuch einer neuen Theorie des Geldes (An Essay on a New Theory of Money), Leipzig, 1816.

Von der Notwendigkeit einter theologischen Grundlage der gesamten Staatswissenschaften (On the Necessity of a Theological Foundation for all the Political Sciences), Leipzig, 1819.

A leading thought in Müller's reaction against Adam Smith is the necessity of abandoning his cosmopolitanism and of founding a national political economy. Believing in the utility of a strong national feeling, he holds that opposition and contest among different countries are desirable. Protection to home industry, and even prohibition of certain exports and imports, are defended on the ground that they stimulate national feeling and give national character to the wealth of a people.[1]

For the same reason, Müller advocates the use of paper money; the precious metals are too cosmopolitan for him. And a further argument which he makes in favor of paper money is that it furnishes the means of avoiding national debts, which tend to divide people into two antagonistic parties, those who possess wealth and those who lack it.[2]

In his system, the state is viewed in a very different light from that in which it has been regarded by any modern writer considered thus far. To him government, in itself, is a good and not an evil. In opposition to the atomistic individualism of Adam Smith, he emphasizes the organic character of the state. He even values war, because it brings into prominence the idea of the state, and the nation as a whole; thus the welfare of others becomes an object, and individual selfishness occupies a less prominent position than in times of peace. But, while Müller desired great centralization and solidarity, he did not wish to extinguish utterly individual freedom: the individual was not to be lost, but was to attain his best development as a closely-knit member of the national organism.

It is, moreover, the state which gives security to property. It is impossible to guarantee that one's wealth shall be inviolable save through the state. Man cannot be thought of as existing in any tolerable situation outside of the state. It is to the state that we must ascribe the continuity of society and of national economic life. Progress and accumulation are thus possible.

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[1] Müller comes near to Mercantilist doctrines, and is classed by Kautz as "Mercantilist-conservative." In this he differs from List. It would be an error to class him as a Mercantilist, however.

[2] See Stephinger, *Die Geldlehre Adam Müller's*, Stuttgart, 1909.

All this meant a different economic point of view. Take value theory, for example. Müller accuses Smith of overemphasizing exchange value and the individual point of view. All things, he said, have a twofold usefulness: one for society; one for the individual. National power (*Nationalkraft*), however, is the fundamental thing, all individual values being gained in and through this power, and existing subject to the effects of world and national movements.

"The problem of permanence is the most important of all political problems." On this account, Müller values the hereditary nobility: it connects the past with the present. Adam Müller was a warm partisan and admirer of the Middle Ages, and longed for a return to them. The world, he thought, had been led astray by gold, Roman institutions, and the enjoyment of material luxuries. Change he hated. The permanence of institutions was dear to him above all things. He thought God had ordained that agricultural laborers should be bound to the soil. Feudal burdens and institutions of all kinds, including the gilds and corporations of the Middle Ages, seemed admirable to him as binding men together and making them feel their unity. Such arrangements were better for the poorer classes, since our modern money system had made slaves of them.

Roscher considers that one of Müller's best characteristics was the earnestness with which he fought the tendency of modern political economists to overvalue economic goods and material enjoyment. He thought that the farmer should not labor exclusively for the promotion of his own material welfare, as Smith had represented him as doing: but, first of all, out of love to God, each man should consider himself a steward, administering his affairs for Him who committed the stewardship unto him.

It was in accord with this general conception that Müller distinguished a *geistiges Kapital* (spiritual capital), which earlier generations hand down to posterity in the shape of a mass of experiences and ideas.[1]

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[1] Criticized by Hermann, *Staatswirthschaftliche Untersuchungen*, 1st ed., p. 54.

Although Müller accused Smith of absolutism in neglecting the differences of place, his own work is not entirely exempt from this error. He did not recognize development in time. He regarded the Middle Ages as representing the normal condition of economic life for all times. He did not perceive that civilization had outgrown that period, but thought that his own time was simply an unhappy transitional state, and that the following generation would return to past institutions with a consciousness of their superiority.[1] Müller may also be criticized for overlooking the part played by individuals and for recognizing them only as they work for the state.[2]

While opposing Smith, Müller did not hesitate to express his admiration for him. He called Adam Smith "the incomparable scholar and the greatest of politico-economic writers of all times." [3] But Müller held that Smith in writing his *Wealth of Nations*, presupposed as a basis for his economic system a condition of affairs and an historical growth such as had taken place in England. This is true. Here, as in many other places, Müller corrected the one-sidedness of Smith. He did this again in calling attention to the evil effects of a division of labor, or, as he put it, "to the wicked tendency of the division of labor" (*die lasterhafte Tendenz der Arbeitstheilung*).

Friedrich List. — Friedrich List was born in Reutlingen, Würtemberg, in 1789. He entered the civil service at an early age, and by diligence and ability soon attained a very respectable position. He heard lectures at the University of Tübingen, and in 1818 was made professor of political science in that institution. He used his professorship as a means of attacking the bureaucratic routine of the civil service in Würtemberg, and at the same time advocated in the press the cause of constitutional monarchy. List opposed the union of the government of Würtemberg with the reactionary elements of the parliament, and was called to account by the government for having written opposition articles, whereupon he resigned his professorship in 1819. He was then made counsel of the German Commercial and Industrial Union (*Deutscher Handels- und Gewerbeverein*), which he had helped to found. An object of this union was to abolish duties on goods passing from one German state to another, and to replace them by duties at the frontiers of Germany.

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[1] Cf. Knies, *Die Politische Oekonomie vom Standpunkte der geschichtlichen Methode*, § 23.

[2] Hildebrand, *Die Nationalokonomie der Gegenwart und Zukunft*, I, Chap. II.

[3] Cf. Roscher's *Gesch. d. Nationalökonomik in Deutschland*, § 163.

At about this time it is probable that List read and was influenced by Ferrier and L. Say, — especially the former, whose *Du gouvernement* was published in 1802, — both of which French writers favored protection.

Reutlingen sent him to parliament as its representative in 1820. At the time, he made a speech in Reutlingen, advocating reforms which were then considered very radical. Among other things, he wished to do away with tolls on roads, tithes, the greater part of the state industries, feudal burdens resting on land, and excise duties; and sought to introduce publicity and trial by jury into the judicial administration. He also favored a decided reduction in the number of civil service officers, the sale of public domains, and a single direct income tax to meet the expenses of government.[1] This displeased the powers in authority, and a petition which he directed to the estates of the realm, in which he pointed out abuses in the administration and in the courts, met with still less favor. He was expelled from parliament, and sentenced to ten months' imprisonment. The government of Würtemberg finally agreed to give him his liberty on condition that he should leave the country. He consented to this, and emigrated to America.

He bought a farm near Harrisburg in Pennsylvania, but later became a successful editor and a speculator in coal mines and railways. In Reading, he published the *National Zeitung*, and wrote a number of articles for it on free trade, which, in 1827, were published in the form of a pamphlet entitled *Outlines of American Political Economy*. This was done at the request of the Pennsylvania Society for the Advancement of

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[1] See Roscher, *Gesch. der Nat. Oek. in Deutsch.*, § 970.

Manufacture and Arts. These articles contained the leading ideas of his great work, *National System of Political Economy*, published fourteen years later. List's residence in America deeply colored his economic views.[1] Some new ideas he gathered from the writings of Alexander Hamilton and more from Daniel Raymond. But chiefly he profited by observation of the young and rapidly progressing economy which surrounded him. "There only," he writes, "have I obtained a clear idea of the gradual development of the economy of a people." "There the contrasts between agricultural and manufacturing countries are exemplified in the most decided manner, and cause the most disastrous revulsions."[2]

In 1832 he went to Germany as United States consul in Leipzig, and, though very ill-received in his native land, never returned to America.

His first literary labor after this was his work on the *Rotteck-Welckersche Staatslexicon*, an organ of South German liberals. He also began at once an agitation for a system of railways in Germany. With this in view, he was a frequent contributor to the press, and wrote a work called *Ueber ein sächsisches Eisenbahnsystem als Grundlage eines allgemeinen deutschen Eisenbahnsystems* (A Saxon Railway System as a Foundation of a Universal German Railway System), published in Leipzig in 1833.

About this time he wrote an essay for the French Academy on a subject which they had assigned: "What must be considered by a Nation desirous of introducing Free Trade in order in the most just manner to reconcile the interests of consumers and producers?" List's essay did not receive the prize, but was declared by the Academy to be *surtout remarquable.* Finally, in 1841, he published the first volume of his great work, *National System of Political Economy*. It was the design of List to complete the work in three volumes, but the first alone was finished.[1] It treated of international commerce, the functions of government in matters of trade, and the German customs union.

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[1] But see Ladenthin, E., *Zur Entwickelung der nationalökonomischen Ansichten Fr. Lists* (Vienna, 1912).

[2] Preface to *National System of Political Economy.*

In his *National System,* List considers chiefly that part of the science which deals with international commerce. *He has one distinct end immediately in view, which is to overthrow the free-trade principles of the "School," as he calls Adam Smith, Jean Baptiste Say, and their followers.* Back of this, lay his desire to show the nations how they might overthrow England's commercial supremacy. He takes up the subject of international commerce, and makes his whole work center about that, because of all the questions of political economy he considers it to have the preponderant interest. The prosperity and even the existence of nations may be sacrificed by a false commercial policy.

At his time, he held, it was of particular importance to devote one's attention to this matter, because the rapid progress of the era rendered it more dangerous than ever before to take any false position. In no previous period had the gap between stationary and advancing peoples increased so rapidly. In past times, it was a work of centuries for one nation to obtain a monopoly of woolen manufactures, while in his own time, he says, it required but ten years for one people to obtain control of the manufacture of cotton, and the start of a few years might enable that most dangerous country, England, to monopolize the flax industry of Europe.

List begins the Introduction to his work by calling attention to the difference between science and practice in the questions of political economy. He maintains that both sides have erred, though the chief error appears to be on the side of the men of theory. The men of the School, the followers of Adam Smith, have looked away from the world as it is, and built upon suppositions which do not exist, never have existed, and whose future existence is problematical. They have regarded the whole world as living in peace and harmony. The differences of nationality they have overlooked.[1] The adherents of Adam Smith have, in fact, established what List calls a cosmopolite (cosmopolitan) or universal economy. Adam Smith followed his master, Quesnay, in calling his book the *Wealth of Nations*, — of nations in general, or mankind.

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[1] His collected writings were published together with a biography by Häusser in three volumes in Stuttgart in 1850 and 1851.

The *National System of Political Economy* has been translated into English and published in Philadelphia by J. B. Lippincott. This translation, made by G. A. Matile, contains a preliminary essay on the history of political economy and notes on the text by Stephen Colwell of Philadelphia, together with the notes of the French translation by Henri Richelot. (The note references are to this translation and the quotations are taken from it.) There is a later translation (1904, Longmans, Green, and Co.) with a good introductory essay by Professor J. S. Nicholson.

Now List does not object to inquiries of this kind, if it be understood that the principles deduced apply to an imaginary and not a real state of affairs. He even admits that the deductions drawn by Smith and Say are correct, "if we assume with this School an universal association or federation of all nations as a guarantee of perpetual peace." He does maintain, however, that matters ought to be considered as they are, and not as they may become in a distant millennium. *Nations do exist, they do go to war with one another, they do take advantage of one another when they can.* The basis of the present life of the world is national life; the nation comes between the individual and humanity; there should be, then, a national political economy as well as a cosmopolitan. Accordingly, List attempts to take a realistic and historical view of political economy. He wishes to build upon the world's experience, to place himself upon the same ground as men of practice, only enlarging the view they take by considering with the aid of history and philosophy "the exigencies of the future and the higher interests of the whole human race." So, immediately after his introduction, he begins a review of the history of free trade and protection in the leading modern nations. His work might, indeed, have been entitled the History of the Policy of Modern Nations with Respect to International Commerce.

He discovers that the economic life of nations, save those lying in the tropics, may be divided into five periods: first, there is the hunting or fishing or savage stage; this is followed by the pastoral stage; people continue to wander for a time, but are finally compelled by external pressure to settle permanently somewhere and gain a livelihood by agriculture, thus entering the agricultural stage; afterwards manufactures are introduced, this constituting the agricultural and manufacturing stage; finally, commerce is added and the fifth stage, the agricultural, manufacturing, and commercial stage, is attained. As these stages represent a continual advancement in material life, the proper office of legislation is to aid in the transition from a lower to a higher stage.

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[1] *National System of Political Economy*, p. 193.

Different measures are required in different periods. In the lowest stage, that of hunters, free trade should be encouraged as the means of developing higher wants in the people, and thus leading them to a more advanced economic stage. As their desires increased, they would take up agriculture more extensively, and improve their cultivation, in order to obtain raw material to exchange for the manufactured articles of foreign countries. Presently, they would manifest a desire to manufacture these articles for themselves, and then it would be time for government to introduce protective measures. Only in this manner could they ever enjoy the advantages of manufactures, even if they possessed natural facilities for them, because older nations with more capital would otherwise strangle their industries in infancy. This could be done by selling even below cost for a time long enough to ruin the weak establishments of the new country. Navigation and manufactures should be protected, until the country might become strong enough to compete with any other country, when free trade should again be introduced to stimulate manufactures and commerce by international competition.

Thus government activity is given a large part in List's teaching.

The countries of the torrid zone, he held, had not the gifts which fitted them ever to become manufacturing nations. Nature had failed to bestow upon the people of the tropics the requisite energy. They possessed, nevertheless, a natural monopoly of many products greatly desired by northern countries, and their only road to wealth lay in continuing to exchange agricultural products for manufactured commodities. Northern nations were to carry on trade freely with the countries of the tropics, but with one another they ought all to adopt protective measures.

No high state of civilization could be attained without manufactures, an exclusively agricultural people being necessarily rude and barbarous. Agriculture and manufactures should be side by side to stimulate each other and to save the cost of transportation. When they are together under the same political power, List said, they are disturbed by no war; they live in perpetual peace.

Besides his attacks on the cosmopolitanism and free-trade doctrines of the School, — the latter being assailed through an examination of England's own growth and the history of the United States, — List also criticized the principle of division of labor, and the emphasis laid on exchange value.

The true principle of the division of labor is the same thing as association of labor or coöperation. If a dozen men are engaged in work on one pair of shoes, the labor is divided, it is true, but the results of that labor are united in the one pair of shoes. The men are all working together. Adam Smith in his *Wealth of Nations* gives an example of division of labor in the manufacture of pins, which has become celebrated. The labor of a few men united or divided — it might be put either way — in this manner accomplishes many times more than it would if they worked separately, each for himself. But suppose that, instead of laboring in the same factory, or at any rate near together, the men who made the heads and those who made the points lived in remote countries, would it then work so well? Might not the men who made the heads manufacture too many in expectation of a greater number of points than were actually imported? Might not, in fact, their entire labor be rendered useless by a war which would cut off the supply of points altogether? Now if this process of division of labor be extended between different countries, might not war or disasters in one country produce a general commercial crash?

Perhaps List is in no place more original or successful than in the exposition of his theory of productive forces and immaterial capital.[1] As at other points, it corrects the one-sidedness of Smith, who had considered value in exchange with little reference to the non-material elements in productive power.

List supposes two fathers, farmers, each having five sons. Each receives an income of $1000 in excess of his necessary expenses. The one saves it and keeps his sons at manual labor. The other spends it in educating three sons for some profession, and in training the other two to become skilled agriculturists. Both fathers die. The first is richer in exchange values. He has left more property. His possessions are divided among five sons. In the second case, the productive powers are greater. The farm is divided between the two sons, who have become so skillful that each half yields its possessor as much perhaps as the whole did formerly. The other three sons have been so trained that they are able to take care of themselves. In the one case there is ignorance, and increasing poverty as the estate becomes more and more divided; in the other, new talents and aptitudes for the production of wealth are developed, and these go on increasing from father to son, to the benefit of society.

The mere accumulation of exchange values, then, is not all-important, but is surpassed by the increase of productive power: "*The power of producing wealth* is therefore infinitely more important than *wealth itself;* it insures not only the possession and the increase of what has been gained, but also the replacement of what has been lost."[2] Thus good morals, intelligence, monogamy, and Christianity are creative of productive forces.

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[1] Cf. Hermann's criticism of this idea as to personal elements, below, p. 561. It should be noted that Müller's works suggest similar ideas, and that List became acquainted with Müller in Vienna. We may suppose that he had some knowledge of his contemporary's thought.

[2] *National System*, Chap. XII, paragraph 3.

All those members of society who tend to develop in any way true manhood and womanhood are productive, not "sterile" or barren, as they might have been called by the Physiocrats, or "unproductive," as Adam Smith designated some of them.

It is false, List claims, to say that labor is the source of value. Whole nations may be in poverty, despite the labor of their citizens. The most depends upon society: whether sciences and arts are developed; whether good institutions, laws, religion, morality, security, and freedom exist; whether agriculture, manufactures, and commerce are harmoniously extended.

These ideas are fundamentally connected with List's theory of protection.

List's views led him to optimistic conclusions as to the future. He was opposed to the Malthusian doctrine, though more to the popular and dogmatic representations of it than to Malthus' own teachings. These List does not appear to have studied carefully.[1]

As in Müller's writings, one finds in those of List a protest against the absolutistic tendencies of the School. Neither one, however, is himself free from such tendencies. Müller, as already observed, neglected the various developments of different times. List, on the other hand, does not consider sufficiently the diversity in the growth of countries. He lays down one rule for all to follow. He simply makes a distinction between the countries of the temperate zones and those of the tropics, a difference which, as Knies has shown, includes a new error. So he is wrong in maintaining that "the production of raw materials and commodities among the great nations of temperate climes has no real importance but in regard to internal trade."[2] The production of raw material is at present of the greatest importance for the foreign commerce of the United States. The division he makes is artificial, and cannot be supported by history. It is unreasonable to suppose that all peoples between the Tropic of Cancer and the Tropic of Capricorn should always be content to devote themselves exclusively to agriculture. And again, the history and present condition of the Orient show a considerable growth of commerce following immediately upon the agricultural stage without waiting for the development of manufactures. Having once recognized a difference of development in place, he ought to have studied more carefully the historic order of national growth.

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[1] Cf. National System, Bk. II, "The Theory," middle of Chap. XI.

[2] National System, pp. 76–77.

List is also open to criticism on the score of not doing full justice to Adam Smith. That great economist was by no means so absolutely blind to national lines, warfare, etc., as List would represent him; but made room for certain duties and bounties and held that "defence is of much more importance than opulence."

List has many followers to this day — though they have generally taken agriculture within the protective wall — and his influence is strong among German officials. German railway policy has been colored by his economic principles; and expanding German nationalism seized upon his arguments for a national marine and a united territory bounded by sea coasts both north and south. In the United States, the platform of the Republican party for a long time was based upon his doctrines.[1]

Henry C. Carey.[2] — Though in many respects a follower of Smith, Carey was also a critic of the Classical political economy. He was a protectionist and a Nationalist. Indeed, his preferences for intuition, and his suggestion that individuals are "molecules" in society,[3] show some tendency toward a social philosophy akin to that of Adam Müller, although he was far from being a Romanticist.

Carey's arguments in favor of protection are somewhat different from those advanced by List. He brings points other than those made by List into special prominence. He lays weight, as does List, upon the civilizing influence of manufactures and commerce, holding that America would be a stupid, uninteresting, and barbarous country, if all Americans devoted themselves to agriculture. Indeed, he states that without well-developed manufactures, agriculture itself would be in a poor way, as the products of the land would then find no convenient market. The cost of transportation to distant countries would consume the greater share of the farmer's profits. (While it might be possible to prove Carey's statement that "the first and heaviest tax to be paid by land and labor is that of transportation," it is surprising to read the sentence following, in which the ratio between the distance goods are transported and the cost of transportation, is defined with mathematical accuracy. The cost of transportation, says Carey, "increases in geometrical proportion as the distance from market increases arithmetically." This is far from being true.)

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[1] A section accordingly split off from that party when it abandoned List's idea of evolutionary protectionism.

[2] For Carey's life and writings, see above, pp. 319 ff. It is to be remembered that Daniel Raymond expressed nationalistic views before Carey. See above pp. 317 f.

[3] See above, p. 327.

However, Carey's arguments in favor of protection by no means depend upon the accuracy of this formula. His two chief points are (1) the benefit of association, and (2) the necessity of returning to the earth what is taken from it.

Association develops individuality, "which has ever been in the ratio of the power of man to combine with his fellow-men." Now if protection favors the growth of association, it ought to be encouraged. This follows from the very definition of social science given by Carey; for it is defined as "the science of the laws which govern man in his efforts to secure for himself the highest individuality and the greatest power of association with his fellow-men." [1] Association cannot take place to any great extent among those who pursue the same employment. Diversity is needed. Unlikes unite and supplement each other. The farmer combines with the blacksmith, and the miller with the baker. The diversity of pursuit promotes and requires intellectual development. America does not wish to become a great farm for a city called England; but this is what would result from following British policy. "It is selfish and repulsive," says Carey, "its essential object being the separation of the consumers and the producers of the world. In that direction lie poverty and slavery." It has impoverished every land which has followed it, as Ireland, India, Portugal, Turkey, and the West Indies. It is even ruining England herself. She is constantly exhausting the countries with which she deals, and is obliged to seek continually new markets. She thus becomes more and more dependent upon the rest of the world. Any change in the policy of other countries or interruption of trade by war or natural calamity, must bring misery to the English people. All efforts are put forth for the one end of cheap production. Wages are reduced, and man is regarded as but a machine. A few become wealthy, but the people as a whole remain poor and wretched.

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[1] *Principles of Social Science*, p. 47 (Philadelphia, 1858–1859).

Carey's second leading argument is the necessity of returning to the soil what has been taken from it. He lays down this law: "The consumer must take his place beside the producer in order to enable man to comply with the condition on which he obtains loans from the great bank of mother earth — the simple condition that when he shall have done with the capital furnished to him, he shall return it to the place whence it has been taken." [1] If this is not done, Carey holds that the soil becomes exhausted, and the land less productive. Accordingly, if a nation begins by exporting raw material, it will end by exporting men, as in the case of Ireland. If, however, produce is carried only to neighboring cities, they return it to the land in the shape of fertilizers.

This argument concerning the exhaustion of the soil is undoubtedly quite specious. It implies a denial of the fact that by foreign trade the wealth of a nation may be increased; for if it be admitted that exchange with other countries is profitable, it must follow that by such exchange a nation may gain increased power to refresh its soil. Other and possibly cheaper ways exist by which produce may be returned to the soil than by retaining a portion for direct application, as, for example, by the use of chemical fertilizers or the growth of certain crops; and to restrict foreign trade may limit a nation's power to acquire or use these means of restoring any lost fertility.

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[1] *Social Science*. p. 53.

It should be remembered that the American, Daniel Raymond, had held views similar to those of Carey. As a follower of Carey, E. Dühring, a German economist, is worthy of brief mention.[1]

Summary. — Of the economists discussed in this chapter, it may be said that they stood for much criticism of the Classical political economy, and especially criticism on the score of its individualism and cosmopolitanism. They all criticized the doctrine of "division of labor," as taught by Smith.

They were Nationalists — although Carey's Nationalism was mixed with a considerable acceptance of Classical economic theories. They emphasized the nation as an important fact, often regarding it as a living organism, or as a quasi-organism, and placing it above the individual and between him and the world. (Well down to this day, German economists have frequently called their science *National Oekonomie.*)

Accordingly, they stood for protection, accusing England's thinkers of recommending in free trade what would benefit their own nation alone, at least in the then-existing stage of relative development.

In this connection, the historical idea frequently appears, and Müller and List are noteworthy as precursors of the Historical School. The former's admiration for the institutions of earlier times, and his treatment of the state as an organism suggest this; but List, with his discussion of stages in the evolution of nations, although not truly historical in spirit, had more influence in this connection. (Both were known to the German Historical School.) To the extent that their analyses of institutions and stages are ideals spun out of the mind, they are, of course, mechanical in nature, and not truly historical.

Consistently with their leading idea, Müller, List, and Carey, in criticizing the one-sidedness of the principle of division of labor, called attention to the association or coöperation phase of it. They emphasized the importance for the national welfare of insuring coöperation among the "divided" elements in production.

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[1] *Kapital und Arbeit*, 1865; *Die Verkleinerer Carey's*, 1868; *Kritische Geschichte der Nationalökonomie*, 1871; *Kursus der National- und Sozialökonomie*, 1873.

Their attitude toward individualism and materialism was such that they were led to attack, in one way or another, the emphasis laid upon objective exchange value. This Müller and List did from a predominantly ethical point of view.

Müller painted the darker tints of the money economy, and desired to retain the remnants of the "natural economy" of the Middle Ages. List accepted the economy of his time, but assailed Smithian teaching on the ground that it worked toward an English monopoly of trade; and Carey likewise developed his doctrine of protection in the interest of his young nation.

Though, in a sense, absolutists themselves, their criticisms served to offset the absolutism of the Classical School, and paved the way for a broader and truer economics.

In appraising Nationalist thought, it is vital to understand the significance of "protection." In a sense, the idea of protection as applied to international trade, is incidental. At bottom, the idea is to "protect" the individual person — not as an "economic man," but as a personality which should have the "self-expression" that is so essential in Romanticism. This idea assumes not only a "self" with its innate and peculiar potentialities, but also other selves as onlookers. Coöperation is thus required. Each "self" must not only be developed; it must also be protected from other selves. But protection of unequal selves (perhaps warped by inferiority complexes!) seems to require a sort of regimentation, and at the same time a revolt against material laws and "standards." Thus both the lowly individual and the backward nation, by group control and social planning, are to be assured self-expression, but subject to a protective system of coöperation. Naturally, this leads to status, as opposed to the test of survival in competition.

Considered thus philosophically, one may see a common thread in the protective tariff schemes of List and Carey, in the Romantic Medievalism of Müller, in the solicitude for "the forgotten man" and in the domestic "allotment" program of the "New Deal," and in the "projects" of the so-called "progressives," both in education and in politics. These are all idealistic thought tendencies which thrive either among persons having a sense of inferiority, or in backward nations, or in periods of prolonged depression.

c. Socialistic Critics

CHAPTER XXII

EARLY NINETEENTH-CENTURY SOCIALISM [1]

The changes involved in the Industrial Revolution brought many industrial maladjustments and economic ills in their train. Poverty, misery, and crises became frequent. Naturally then, in seeking reasons and remedies for these things, some were led to criticize the whole movement and the system of economic thought which attended it. The critic, Sismondi, was so inclined, but accepted the existing social order and the main outlines of the Classical system of thought. Others sought relief in a romantic reaction to the cast-off institutions of medieval times.

In this chapter, however, a group of thinkers will be discussed, who, while accepting the technical industrial progress of the time, with its large-scale production and division of labor, opposed some of the fundamental ideas and institutions of the existing social order, and censured the economists for postulating certain social institutions as though they were ultimate and merely to be taken for granted. They sought no mere chimera. They proceeded upon no merely moral basis. And in this general way, their schemes differed from those of Sir Thomas More, Mably, Morelly, Godwin, and Babeuf. Theirs was an economic point of view; and their criticism sprang out of the throes of the Industrial and French Revolutions. In a word, the men now to be treated were anti-capitalistic, and advocated sweeping economic reforms. They criticized the existing idea of private property and competition. They were either Socialists or Communists.

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[1] See Ely, *French and German Socialism;* Kirkup, *History of Socialism;* Rae, *Contemporary Socialism;* Menger, *The Right to the Whole Produce of Labor;* Laidler, H. W., *A History of Socialist Thought* (1927); Sombart, *Socialism and the Social Movement* (English translation from sixth German edition, London, 1909); Gide-Rist, *Histoire des doctrines économiques;* and many others referred to in those works. This and a succeeding chapter on Socialism do not aim to present a full account of the subject in all its social and political aspects, but merely to indicate some aspects of its significance as a criticism of economic theory.

It is characteristic of these early Socialists that their thought partook of the transitional condition of the time. As youths, the first of them imbibed the optimism of the early French Revolution, as illustrated by Godwin, with his ideas of human perfectibility.[1] The idealistic nature philosophy of the eighteenth century lingered on into the nineteenth, and is seen in their thought. But all the time, the class of permanent wage earners, and a realization of its oppressed condition, grew. Modern industrialism was beginning to take shape. The Smithian economics was essentially *bourgeois* or capitalistic and middle-class; and as the *proletariat* or wage-earning class became more numerous and distinct, the conflicts between their interests and the doctrines of the Classical economics began to appear. On the one hand, the revolutions in philosophical and political thought had hardly been consummated, and their principles had not been thoroughly applied. On the other hand, the evils of the revolution in industry were beginning to show. But for the time, men had reacted against the excesses of the French Revolution; and, as the uneducated and riotous proletariat seemed incapable, and as its class consciousness was undeveloped, self-help did not seem adequate as a solution. What, then, was to be done?

1. The Utopian or Bourgeois Socialists. — Under such circumstances, there arose the three noted Utopists, Saint-Simon, Owen, and Fourier, who almost simultaneously conceived the idea of bringing down aid to the poor from above, and of regenerating mankind by educating them to live in an ideal social order guided by the wisest and best among them. In their schemes for social reform, these men were speculative, and reasoned from ideal postulates. Moreover, they were broadly humanitarian in their plans, differing from later Socialists in that they did not seek to organize the laborers in class conflict, but to improve the lot of humanity through educational experimentation. They were not revolutionary, but appealed to the dominant classes for aid. They were rather *bourgeois* in their ideas, the proletarian movement not having become marked until after 1830.

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[1] Above, pp. 260 f.

a. *Saint-Simon and the Saint-Simonists.* — Saint-Simon (1760–1825) is notable for his breadth of view and his creative suggestiveness.[1] He himself desires to depart less radically from the existing order than Owen and Fourier, though his followers went further. While suggesting modifications, he is not so clearly opposed to private property, and seems to allow it in capital when that is in the form of what he calls an investment worthy of compensation.

Neither does he have in mind the conflict between labor and capital, but a more general one between the workers and the idle. Society should be reorganized in such a way that all must work.

The heart of Saint-Simon's idea was to direct the labor of the nation so as to ameliorate the physical and moral condition of all its members. The chief needs he considered to be regular work and general education or knowledge.

To this end, he advocated a broad industrialism. To his mind, the industrial class — including all workers — had achieved the Revolution, and upon this class depended freedom. The present social classes must go. Three classes would come into existence: "savants" (intellectuals), artists, and those engaged in industrial pursuits. The nation would be organized on an industrial basis in which industrial chiefs would control production. Government would thus be reduced to the direction of a national association for industrial purposes. Men would then cease exploiting one another, and mutually turn to exploit the earth. At first, Saint-Simon appears to have believed that if only the present class structure were abolished, a natural hierarchy of ability would establish itself, but later he came to feel that more positive action would be required.

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[1] Writings of economic significance: —
Lettres d'un habitant de Genève, 1803.
L'industrie, 1817.
L'organisateur, 1819.
Du système industriel, 1821.
Catéchisme des industriels, 1823.
Nouveau Christianisme, 1825.

All this, of course, implies his criticism of the existing system of directing industry.

His followers, and notably Bazard and Enfantin, went further than Saint-Simon in attacking private property.[1] As the idle class must go, and all are to work, capitalists, as such, cannot exist. In so far as their income arises from the ownership of capital, it is not earned, but is the result of exploiting labor. Under the present system, the industrial chiefs dictate terms on pain of starvation, for they own the instruments of production.[2] Moreover, they keep these instruments through the institution of inheritance. Inheritance must be abolished, then, and the instruments of labor be socialized. In a word, a system of collectivism is advocated.

From the point of view of production, too, it was maintained that the system of inheritance does not insure that property will fall into the most capable hands.

The Saint-Simonists, like Sismondi, point out that in the organization of labor the problem is to harmonize production and consumption. Here the economists turn to *laisser-faire* competition. But this leads to struggle and loss, and crises result from recurring disturbances of the balance between production and consumption. The Socialists complain of isolated efforts and egoism.

b. *The Associationists: Owen, Fourier, and Thompson.* — Saint-Simon differed from the other Utopian Socialists who are to be discussed, in that his idea was based upon a broader socialization of industry than theirs. He differed in his idea of centralization. While Saint-Simon would have reformed society in a lump, a method which could easily suggest State Socialism (though he himself did not advocate such a radical and positive step), they sought reform in voluntary local communities. Owen and Fourier are both characterized by their advocacy of associations with a limited membership, and may be distinguished by the term "associationist." These associations were to be voluntary, springing from the mutual consent of the members.

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[1] See *Doctrine de Saint-Simon, Première année, Exposition,* 1829. (Paris, 1830.)

[2] *Ibid.*, 6° Séance.

Robert Owen (1771–1858) [1] was less of an idealist than Saint-Simon and Fourier. He was somewhat more practical in his methods, but altogether unhistorical in spirit. His philosophy, however, had much in common with theirs. He believed that men are naturally good: evils are not inherent in the nature of things, but lie in the capitalistic system, which perverts the natural order.

Concretely, there are three barriers: private property, religion, the institution of marriage. In his ideal communal order, these barriers would be removed, and man's natural goodness could find free expression.

At an early age, Owen in 1800 became manager of extensive cotton mills at New Lanark. Here he was a witness of current labor abuses. He estimated that his employees were producing a vast amount of real wealth, in which they had no share, and he believed that they lacked a chance to develop their faculties adequately. He accordingly came to advocate education and a better environment for working people.

Then his ideas grew more communistic, and he demanded the abolition of profits, speculation, money, and well-nigh the whole machinery of exchange then current. Owen believed that the just price of a good is its cost. To charge more is unjust. But profits seemed to him to arise from selling above cost, and to stimulate overproduction and lead to crises.

Money based upon the value of precious metals, seemed to him to help confuse the relation between the true values of goods in an exchange, and he advocated the use of labor notes based upon the labor time involved in producing the goods as a medium in its place.[1]

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[1] For his earlier views see *A New View of Society*, 1812. His maturer doctrine is found in *The Book of the New Moral World*, 1820.

Owen severely arraigned the idea that competition is in the best interests of society.

Charles Fourier (1772–1837) was almost exactly contemporary with Owen, and had very similar ideas.[2] Although his thought is marred by loose and inexact statement, he was a keen critic of the existing industrial system.

Association is the leading idea in his system. Although its operation is impeded in the existing order, it is made a principle of attraction among men, like the law of gravitation in the physical world. Harmony could be obtained only in his communities, called phalanxes, which were to contain some 1800 members, and carry on production in the interest of the group. These groups would be large enough to afford all useful combinations, but not so large as to necessitate useless classes (soldiers and policemen) or to prevent general coöperation.

To the economist, Fourier's ideas concerning labor and its reward, are the most interesting. He taught that all labor may be pleasant; it is only overwork that makes it painful, and overwork would be unnecessary in his associations. Moreover, a desire for change is recognized, and each member could take up some different task at the end of two hours. Between the ages of eighteen and twenty-eight, a man could produce enough to warrant his passing the remainder of his life in leisure. Labor is divided by Fourier into three grades: necessary, useful, and agreeable. The first of these was to receive the highest reward; while pleasant labor of all kinds would be the lowest paid. All members were to receive a minimum. Thus his scheme makes exertion the chief basis for reward.

Unfortunately, Fourier gives us no answer to the question,

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[1] This, it will be observed, would be a narrow application of Ricardo's earlier idea of a measure of value.

[2] *La théorie des quatre mouvements et des destinées générales*, 1808.
Traité de l'association domestique agricole ou attraction industrielle, 1822.
Nouveau monde industrial et sociétaire, 1829.

How, under a system of self-development and free play for individual desires, is consumption to be adjusted to production?

Perhaps Fourier is to be regarded as inconsistent on one important point, — either that, or he was not a thoroughgoing Socialist, — for he provided for a return to capital, as such. The surplus remaining after the minimum had been given to each member, was to be distributed in such a way that five twelfths would go to labor, four twelfths to capital, and three twelfths to talent.

Fourier's merits have been summed up as follows: "There is a good deal of truth in some of his critical remarks. The importance of coöperative production has been recognized chiefly in consequence of his first pointing out the economical benefits of association. The narrow-minded fear of wholesale trade, and machinery, too, was in a measure dispelled by Fourier's unqualified recognition of their value. His remarks on the unnecessary hardships of labor and the evil consequences of excessive toil have had their influence on modern factory laws. . . . Sanitary reforms, and improvements of the laborer's homestead . . . owe not a little of their origin to the spread of Fourier's ideas." [1]

William Thompson was an Irish Socialist, whose fame has been less than his deserts. His chief work,[2] entitled *An Inquiry into the Principles of the Distribution of Wealth Most Conducive to Human Happiness,* was published in 1824, and contains a clear statement of ideas that form the basis of the later Marxian Socialism. In his own proposals for reform, however, Thompson was a follower of Owen.

He argues that labor produces all value in exchange, and that all the product of labor should belong to laborers. But, with our present social institutions, labor gets a bare subsistence remuneration, the balance of its product going to land and capital. Under the existing social order, the dominant capitalist class regards the difference between subsistence wages and the increasing value of the social product as being a surplus value due to its superior intelligence and skill. By reason of its political power, this class is enabled to make an unjust deduction from labor's product.

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[1] Kaufmann, *Schäffle's Socialism,* cited by Ely, *French and German Socialism,* p. 100.

[2] Thompson also wrote: *An Appeal of One Half the Human Race, Women, against the Pretensions of the Other Half, Men,* 1825; *Labour Rewarded, the Claims of Labour and Capital Conciliated,* 1827; *Practical Directions for the Speedy and Economical Establishment of Communities,* 1830.

Accordingly, Thompson thinks that there must be a reconstruction of social institutions. But he does not carry his ideas to their logical conclusion, for he would not abolish property rights, nor take the whole produce of labor from capitalists and landowners. "Thompson's object like that of so many other socialists, was to prove the injustice of unearned income and private property . . . but the communistic tendencies which he borrowed from Owen prevented him from drawing its positive consequences."[1]

Thompson's great significance lies in the fact that the basal ideas of such later Socialists as Rodbertus and Marx concerning surplus value, may be traced to him.

2. The Transition to More Realistic[2] and Proletarian Socialism in France (1840–1848). — In so far as class conflict was involved, all the insurrections and revolutions down through 1830 were essentially *bourgeois*, that is, capitalist and middle-class. They were not of and for wage earners or laborers. But early in the thirties, there came a change in this regard. Although the French revolution of July, 1830, was a *bourgeois* affair, it served to bring the proletariat into greater prominence. Then in 1831 the Lyons silk-weavers rose in insurrection. By 1837, the Chartist movement was on foot in England. Finally, in 1848, the great proletarian revolution occurred in France, and from that time modern realistic Socialism may be dated. At about the same time, German Socialism took the lead.

There is, perhaps, some degree of realism manifest in the work of the following Socialists. Yet they are by no means freed from the Utopian notion that all that is needed to reform society is to invent some scheme through which their ideals might speedily be realized. Their thought was transitional.

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[1] Menger, A., *The Right to the Whole Produce of Labour*, p. 59 (Foxwell ed.).

[2] The words "realism" and "realistic" are not here used in their philosophical sense, but as used in art and literature, — meaning life-like and based on facts rather than imaginary or utopian.

a. *Louis Blanc.* — Louis Blanc (1813–1882) was not the most original of the early Socialists, but he is notable for being the first to make the connection between politics and social reform. The preceding Socialistic thinkers had depended upon education — upon a recognition of the truth of their doctrines — for the spread of the system advocated. Association was to be voluntary and unaided by the state. With Blanc, the state was depended upon to aid in carrying out the system proposed.

But in a sense Louis Blanc is only transitionary in this regard. Indeed, he is sometimes classed as an associationist,[1] and he advocated social workshops (*ateliers sociaux*) where men in similar industries would coöperate. Socialism proper would thus exist only within various separate branches of industry, presumably leaving the relations between these branches to the régime of contract and competition. Blanc's associations were to be initiated and subsidized by the state, however, and were not the self-sufficient units of Owen and Fourier.

Louis Blanc's celebrated work, *Organization du travail* (Organization of Labor), was published in 1841.[2] The central point in his thought is a desire for the broad and perfect development of each man's personality. Proceeding from the idea of the brotherhood of man, he advocated payment not according to service or productivity, but according to *needs* or *wants*. Only by giving to each according to his needs, could his goal be attained. His system, therefore, is not like that of the later Socialists, based upon a demand for "the whole produce of labor," but upon the more philanthropic idea of a right to subsistence (*droit à la vie*).

Certainly such a distribution of property and income does not now exist; and competition, to which distribution in the existing order is submitted, he fairly anathematized. It is murderous warfare. It places a man outside of society, emphasizing his rights without indicating his duties. We must seek a new organization which will abolish individualism, competition, and private property, and in their stead place fraternity and harmony.

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[1] E.g., Gide-Rist, *Histoire des doctrines économiques.*

[2] There were considerable additions in a fifth edition that appeared in 1850.

His *ateliers*, as established in the different industries, were to bring production to this level and to afford to all a "natural" right, that is, the right to work (*droit au travail*). But the poor laborers were in no position to set up these shops; therefore the state was appealed to, and was to organize them and furnish the funds. After the first year, however, the heads would be elected.

Inasmuch as Louis Blanc advocated needs or wants as a basis for rewards, he is to be classed as a Communist. He was no *égalitaire*, however, for he wrote: "Equality, then, is only proportionality, and it exists in a true manner only when each one in accordance with the law written in some shape in his organization by God himself, *produces according to his Faculties and consumes according to his Wants.*"[1]

b. *Proudhon.* — With Pierre-Joseph Proudhon (1809–1865), one comes to a thoroughly proletarian Socialism, and the beginning of one line of Anarchism. Indeed, one finds in his thought much that foreshadows the doctrines of the more "scientific" Socialism taught by Marx and Engels. More sharply and directly than any of the others, Proudhon centered his attack upon property rights. Property, as distinguished from possession, he said, is robbery; property-owners are thieves.[2] Even to common property in a communistic state, he objects, and in this foreshadows the split between Socialism and Anarchism.

He makes short work of the idea that occupation justifies private property, turning his attention chiefly to land. J. B. Say is quoted as justifying property in land on the ground that land is fixed and limited in extent; but that, Proudhon argues, merely explains the existence of property, — it does not justify ownership. And Comte's argument from limited supply seems to Proudhon to go against him, for that is the reason why land should be free to all. If it were unlimited, all might have property in it, and no one would be hurt.

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[1] *Organization du travail*, 9th ed., p. 72. Later, as a practical measure, Blanc proposed absolute equality.

[2] *Qu'est-ce que la propriété?* (What is Property?), 1840. *Works*, Vol. I, translated by Benjamin R. Tucker, Boston, 1876.

But what of the labor theory of property? If labor is to justify property, Proudhon thinks that whenever any one labors on a farm he must acquire property rights in it. "The laborer retains, even after he has received his wages, a natural right of property in the thing which he produced." What labor does is to create increased capacity, and its proper reward is the additional income that results. This does not convey ownership in the soil itself. That no man has made. In short, land is the gift of nature, bestowed upon all equally, and no man has a right to appropriate it and its rent for his own use.

Property-owners are robbers because they have made others labor for them, who thus lost in laboring what the owners gained. All who labor should become proprietors: "this is an inevitable deduction from the acknowledged principles of political economy and jurisprudence, and when I say proprietor, I do not mean simply (as do our hypocritical economists) proprietor of his allowance, his salary, his wages, — I mean proprietor of the value which he creates, and by which the master alone profits."

Here, then, is the idea of a surplus value, arising from the exploitation of labor.

At one point, Proudhon undertakes to explain how it is that capitalists take a profit from the laborer's product. The capitalist pays each laborer of a group a mere day's wage. But in the combined labor of the group there is an advantage for which he does not pay. There is a union or harmony through which the product exceeds the sum of the individual products of the separate laborers.

As a remedy, he concludes that labor should receive an additional proportion of the product.

In accordance with these ideas, Proudhon propounds a *l*abor theory of value. He begins by mocking the economists for attempting a science while professing that there is no absolute measure of value. To him, the matter is simple. "The absolute value of a thing, then, is its cost in time and expense." A diamond in the rough is worth nothing; cut and mounted it is worth the time and expense involved. But it sells for more than this; — that is because men are not free. Therefore, "society must regulate the exchange and distribution of the rarest things, as it does that of the most common ones, in such a way that each may share in the enjoyment of them." Value based upon opinion (or utility) is delusion and robbery.

Somewhat paradoxically, Proudhon attacks the thought of his Socialistic predecessors.[1] He rejects association of labor, as encroaching upon the liberty of the laborers. Likewise, Communism, he thought, would lead to inequality, being an exploitation of the strong by the weak. His position can be interpreted only by grasping his desire to *harmonize property and community through liberty*, after the manner of Hegel's dialectic. Thus he would not have abolished property, but rather have limited it. He would have confined property rights to those things that are clearly produced by labor, and have based them upon labor. Interest, rent, and profits he would have abolished.

In this course, a distinction is drawn between "ownership" and "possession," which came more easily to one who lived under the civil law than to an Englishman. Possession, he would have allowed to individuals. Thus liberty and property could be made to exist side by side. On the other hand, community must modify property, but must not restrict freedom. Therefore, he taught an anarchistic sort of Communism! This latter paradox he solved through a belief that liberty and equality were one, — that is, the social coöperation, easy tasks, and equal means of performing them, which he would have instituted, would make equal rewards natural. Liberty exists only in the social state; in such a state all have equal capacities for performing tasks; social tasks are equal.

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[1] See *Système des contradictions économiques, ou philosophies de la misère*, 1846; and also the earlier work, *What is Property?*

To this whole group of ideas, Proudhon applied the term "mutualism." By this he meant that reciprocity of services was to govern economic relations: rights and duties were to be mutual.

The idea is illustrated by the chief positive reform that he advocated, namely, his celebrated exchange bank. Here products would be exchanged without the intervention of money. Paper money would be issued for goods according to the labor-time required for their production, and this medium would exchange equally for any goods which cost the same labor. Credit, too, would be granted to every one, helping reduce interest to its normal rate, which according to Proudhon is nil. Consequently, the instruments of production could be freely obtained by all, and landlords and capitalists would cease to exist. Thus would mutuality reign.

A notable feature of Proudhon's thought is its emphasis of the collective or social character of modern production. Neither labor, nor land, nor capital is productive alone; production results from their coöperation. And he quotes the economist Droz [1] with approval as saying: "Say credits capital with an active part unwarranted by its nature; left to itself, it is an idle tool." All production being necessarily collective, the laborer is entitled to a share in the product. All accumulated capital being social property, no one can be its exclusive proprietor.

Summary. — The foregoing " Socialists " range all the way from those who merely advocated radical schemes of social reform, like Saint-Simon, to Proudhon, who was touched by that modern class consciousness which has characterized later Socialism. Moreover, they differed widely in the basis of distribution which they favored: Owen and Blanc were Communists, and believed in approximate equality in distribution, while the others proposed rewards in accord with some measure of productive contribution. Nevertheless, they were all pioneers in Socialistic thought, and all were more or less Utopian, or "unscientific," — a statement, the full force of which will be realized when their ideas are compared with the thought of Rodbertus and Marx as set forth in a later chapter.

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[1] See above, p. 401.

It is scarcely necessary to criticize the thought of the early Socialists. Their Utopianism vitiates a great deal of it. It is too one-sidedly idealistic. It hardly touches scientific economic theory, being essentially ethical. And from a practical standpoint, its bourgeois origin rendered it inadequate to meet the demands of a suffering and increasingly class-conscious proletariat.

On the constructive side, a characteristic weakness is shown in the absence of any practicable plan for distribution according to wants or the other bases proposed. The ideal of "equality" is ever illusory: absolute equality is relative inequality, and equality relatively to unequal wants can hardly be attained by conscious control — certainly not by adopting any given set of institutions. In some cases, the whole scheme is invalidated by containing discordant elements which would probably intensify competition, etc.

Proudhon's theory of value is subject to the same criticism as that of Marx, who was influenced by him, and the criticism of Marx's theory will be found in a later chapter.

Considered from the standpoint of their effect upon the stream of economic thought, these Socialists of the first half of the nineteenth century, though their influence was largely indirect and rather gradual, are of considerable importance. In the first place, they raised the question of distributive justice in such a way as to make it more urgent, and placed it in a new light. Put in another way, they criticized economists for being content with what is, rather than what ought to be, and in so doing they especially criticized them for taking for granted various social institutions. In these criticisms, the Socialists discussed in the present chapter led the way for the German Historical School of economists, and the close relation between the Historical School and the "Socialists of the Chair" is suggested.

In the second place, then, these early Socialists brought out the significance of property and inheritance, with respect to both distribution and production. On the one hand, they all emphasized the importance of property rights as affecting distribution, *tending to place the question of property distribution before that of income distribution;* while the economists generally took the former for granted. On the other hand, some of them made the point that the socialization of property would do away with wasteful or less useful production. They did not accept private property as a fixed fact. They taught that it is a relative institution with an historical development. So far, they were correct. But they went beyond reason when they argued for the abolition of private property, instead of modifying the scope or content of property rights.

Again, they all taught some basis for distribution other than costs as determined by competition. With Saint-Simon, it was "To each according to his capacity, to each capacity according to results." Fourier would have rewarded "each according to his capital, his labor, and his skill." Louis Blanc made wants — or was it "needs"? — the basis. Proudhon said: "The capacity, given to all, of accomplishing a social task, — and the impossibility of paying one laborer, save in the products of another, — justify the equality of wages." These ideas, of course, would chiefly affect wage theories and policies, in so far as they exerted any influence.

Their general emphasis of the social point of view and of the social nature of the productive process, no doubt served as a strong corrective for the extremely individualistic tendencies of the Classical School.

And closely related to this point, is the influence that they have exerted in the direction of practical coöperation. Owen and Fourier are to be remembered in this connection. Not only did they stimulate many practical experiments, but the discussion of their ideas, or those similar to them, has figured prominently in theories of labor and wages.

Finally, these men had ideas of some sort of social evolution.

They are to be remembered in connection with the idea of "stages" in the evolution of society, the thought of Saint-Simon and Fourier being most elaborated on this point. The Saint-Simonians believed that "Humanity is a collective being which develops; that being has grown from generation to generation, as an individual man grows, in the succession of life periods [*âges*]." [1] And Fourier thought of humanity as pursuing a career in which there were three great stages with eight periods. But all these Utopists lacked a true historical sense of institutional development, a fact which is evidenced by their failure to appreciate the social value of private property, religion, and marriage, and their advocacy of the abolition or destruction rather than modification of such institutions.

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[1] *Doctrine de Saint-Simon*, 1° An., p. 45. August Comte's ideas along this line were in part drawn from Saint-Simon, who was his teacher for a time.

IV. THE RESTATEMENT

Ricardo had developed a certain side of Adam Smith's political economy, carrying it to its logical conclusion. Bentham developed utilitarianism; Malthus added his theory of population; Senior his abstinence theory; and several writers contributed refinements at this or that point. There was still room, however, for one who should be broad enough to survey the whole field, and fuse these various elements into a systematic body of doctrine. In fact, there was need for a revision of the Classical economics: a revision which would take into consideration both the criticisms of the old system of thought, and the changes in industrial and social conditions; one that would realize the insufficiency of the existing political economy with relation to the problems of modern society, and at least prepare the way for a new economics.

At this juncture, John Stuart Mill came upon the scene. Mill was influenced by most of the thought tendencies which have thus far been observed. Upon him, played not only the full force of Ricardian economics, supplemented by Benthamic utilitarianism, but also such divergent or opposite streams of thought as French Socialism, Comte's broad concept of a social science, and what Mill himself called the Germano-Coleridgian philosophy of history. Sismondi's ideals of social reform were well known to him. He was even acquainted with Carey's bizarre criticisms of Classical doctrines. He wrote at almost exactly the same time that Roscher and Hildebrand did.

The result, however, was no revolution — not even a reconstruction — but merely a *restatement* of Classical economics (with minor revisions), mixed with thoughts on social reform policies. As we shall see, Mill was too deeply imbued with Ricardianism to be able either to rise much above it in his economics proper, or to change his economics into a sociology or a philosophy of history — had that been desirable.

CHAPTER XXIII

JOHN STUART MILL

If Adam Smith may be called the Father of Political Economy, John Stuart Mill was his chief heir in the direct line. He it was who, about the middle of the last century, combined, restated, and modified the teaching of Smith, Malthus, and Ricardo, and so successfully that his work has had an effect upon English thought second to none.

Writing at a considerably later date than his great predecessors, Mill fell within the play of new forces. As will be seen, the common characterization of his thought as transitional, is strikingly just. It is essential, then, to study carefully his biography, to the end that these forces may be appreciated.

Life and Works. — John Stuart Mill was born in London, May 20, 1806. His father, James Mill, was a man of considerable eminence as an historian, a philosopher, and a political economist. The best-known work written by James Mill was a History of British India. He wrote also a political economy, which, though little more than a résumé of the work of others, was of considerable influence with followers of Ricardo.

The education of John Stuart Mill was a remarkable and, in some respects, a most successful experiment. It was partly to describe this experiment that Mill wrote his *Autobiography*. From the earliest years of his life his father trained him with the intention of making him precisely what he became. Mill undoubtedly exaggerated the effects of the education he received, and underrated his own natural powers; but its influence was deep and lasting. He could not remember the time when he began the study of Greek, but was told that it was when he was three years of age. In his eighth year he began the study of Latin, and when twelve, had read some of the chief classics in that tongue. Between his seventh and tenth years, while living in Newington Green, he was accustomed to take daily walks with his father, during which he would render an account of what he had read the preceding day. While reading, he made notes on slips of paper and from these prepared a narrative. In this manner he read and discussed Robertson's histories, Hume, Gibbon, Watson's *Philip II* and *Philip III*, Hooke's *History of Rome*, the last two or three volumes of Rollin's *Ancient History*, the Langhornes' translation of Plutarch, Burnet's *History of His Own Time*, and the historical part of the *Annual Register* from the beginning to about 1788. He appears to have read these works voluntarily, but his father assigned him other books to read, which would not have interested him sufficiently to have led him to read them of his own accord.[1]

It was after he had accomplished this work in Latin, Greek, and history, together with some training in logic, and when he had already arrived at the advanced age of thirteen, that he took a complete course in political economy. This was in 1819! Two years before this time, Ricardo had published his treatise on *Political Economy and Taxation.* Mill says of this work: "My father's loved and intimate friend, Ricardo, had shortly before published the book which formed so great an epoch in political economy; a book which never would have been published or written but for the entreaty and strong encouragement of my father; for Ricardo, the most modest of men, though firmly convinced of the truth of his doctrines, deemed himself so little capable of doing them justice in exposition and expression, that he shrank from the idea of publicity." [2] Ricardo's work was not suited for use as a textbook, and the elder Mill accordingly conceived the idea of writing one which should contain Ricardo's doctrines. In his walks he lectured to his son, and made him write out and read the next day an account of what had been said.) The notes thus prepared were used by the father in writing his *Elements of Political Economy*. After this work was completed, young Mill went through Ricardo with his father, who questioned him and explained difficulties only after the boy had given the best explanation he could. (The study of Adam Smith in the same manner followed that of Ricardo.)

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[1] Among such he mentions Millar's *Historical View of the English Government*, Mosheim's *Ecclesiastical History*, M'Crie's *Life of John Knox*, Sewel's and Rutty's Histories of the Quakers, Beaver's *African Memoranda*, Collins' *Account of the First Settlement of New South Wales.*

[2] *Autobiography*, p. 27.

When Mill was fourteen years of age, that is, in 1820, he went to France and spent a year there. While in Paris he passed a considerable time in the house of Jean Baptiste Say. It will be thus seen that (Mill was brought up under such economic influences as would naturally lead him to a firm belief in the doctrines of Adam Smith, Malthus, and Ricardo.[1])

Upon his return to England in 1821, when fifteen years old, he began the study of Roman and English Law. His father put into his hands at the commencement of his legal studies Dumont's *Traité de législation*, which contained an exposition of the principal speculations of Jeremy Bentham, the distinguished English jurist and founder of the utilitarian system of morals. Bentham was a friend of his father's, and young Mill had enjoyed the advantage of living with him a part of each of the years from 1814 to 1817.

What Mill says of his perusal of Dumont's *Traité de législation* is very significant, and quite remarkable when one remembers that it is the description of the thoughts and feelings of a boy of fifteen: —

> "The reading of this book was an epoch in my life; one of the turning points in my mental history.
>
> "My previous education had been, in a certain sense, already a course of Benthamism. The Benthamic standard of 'the greatest

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[1] Mill had undoubtedly remarkable advantages. He was surrounded by great men, as, e.g., his father, his father's friends, Ricardo, Bentham, Grote, and John Austin. His own friends and companions were Charles Austin, Macaulay, Hyde, Charles Villiers, Strutt, afterwards Lord Belper, Romilly, afterwards Lord Romilly and Master of the Rolls, William Eyton Tooke, son of the political economist who wrote the *History of Prices*, William Ellis, an original investigator in political economy, George Graham, Frederic Maurice, and John Arthur Roebuck.

happiness' was that which I had always been taught to apply; . . . Yet in the first pages of Bentham it burst upon me with all the force of novelty. What thus impressed me was the chapter in which Bentham passed judgment on the common modes of reasoning in morals and legislation, deduced from phrases like 'law of nature,' 'right reason,' 'the moral sense,' 'natural rectitude,' and the like, and characterized them as dogmatism in disguise, imposing its sentiments upon others under cover of sounding expressions which convey no reason for the sentiment, but set up the sentiment as its own reason. It had not struck me before that Bentham's principle put an end to all this. The feeling rushed upon me that all previous moralists were superseded, and that here, indeed, was the commencement of a new era in thought. . . . When I laid down the last volume of the *Traité*, I had become a different being. The 'principle of utility,' understood as Bentham understood it, and applied in the manner in which he applied it through these three volumes, fell exactly into its place as the keystone which held together the detached and fragmentary component parts of my knowledge and beliefs. It gave unity to my conceptions of things. I now had opinions; a creed, a doctrine, a philosophy; in one among the best senses of the word, a religion; the inculcation and diffusion of which could be made the principal outward purpose of a life. And I had a grand conception laid before me of changes to be effected in the condition of mankind through that doctrine."

During this "crisis" in his mental history, also, Mill became acquainted with and was admittedly influenced by the Socialistic doctrines of the Saint-Simonian school.[1] In later years, and before writing his *Political Economy*, he reacted from the somewhat extravagant notions concerning the merits of Benthamism.

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[1] See above, p. 427. Since Mill's death in 1873, Miss Taylor, his step-daughter, has given to the world the contents of a manuscript he left, which was the beginning of a work on Socialism. It was published first in the *Fortnightly Review* and has since appeared in book form. In a "Preliminary Notice" Miss Taylor says: "It was in the year 1869 that, impressed with the degree in which even during the last twenty years, when the world seemed so wholly occupied with other matters, the socialist ideas of speculative thinkers had spread among the workers in every civilised country, Mr. Mill formed the design of writing a book on Socialism. Convinced that the inevitable tendencies of modern society must be to bring the questions involved in it always more and more to the front, he thought it of great practical consequence that they should be thoroughly and impartially considered, and the lines pointed out by which the best speculatively-tested theories might, without prolongation of suffering on the one hand, or unnecessary disturbance on the other, be applied to the existing order of things."

His undoubtedly deep emotional nature, under the influence of his wife, led him more and more toward idealistic Socialistic beliefs. He could never be classed as a Socialist, however, and his latest writing shows that he had reacted somewhat from his leaning toward Socialistic doctrines.

Mill professed to have obtained great assistance in his work from his wife, a Mrs. Taylor before she married him. He calls his acquaintance with her "the most valuable friendship of my life." He probably goes too far in ascribing to her all that is best in his writings, as he does frequently. He thought his work on *Liberty* destined to live longer than any other of his works because she had gone through every sentence of it with him. It is doubtful if the majority of his readers agree with him in the comparative estimate he placed on that work.

In 1823, Mill obtained an appointment from the East India Company, in the office of the Examiner of India Correspondence, finally rising to the post of Examiner, in which position he remained as long as the East India Company existed as a political body. This was until 1858. He considered his office work as on the whole an advantage to him, inasmuch as it brought him in contact with the business world and saved him from speculative errors into which he might have fallen, had he been less acquainted with real life and the motives by which men are influenced.

Mill began to publish his writings in 1822, when sixteen years of age. At first he wrote articles for the newspapers on economic subjects, liberty of thought and speech, etc. The *Westminster Review* was founded in 1824 by Bentham as an organ of Radicalism, and to this Mill was a frequent contributor. In the following years, he was employed by Bentham to revise and edit the manuscript for his five-volume work on Evidence. But he continued to write numerous newspaper articles and essays for magazines, particularly for the *London and Westminster Review*, of which he was editor for a time, and later for the *Fortnightly Review.* Five volumes of his essays have appeared in book form, with the title *Dissertations and Discussions.*

The first important book Mill published was his *System of Logic*, the first edition of which appeared in 1843, the ninth in 1875. It is regarded generally on the Continent, as also in England, as one of the most important works on the subject ever written. A collection of *Essays on Some Unsettled Questions of Political Economy* appeared in 1844, although they had been written in 1830 and 1831, and at the time had been declined by a publisher. The *Principles of Political Economy* appeared early in 1848. A seventh edition was published in 1871. The following works appeared successively: *On Liberty*, *Considerations on Representative Government*, *Utilitarianism*, *Examination of Sir Wm. Hamilton's Philosophy*, and *Subjection of Women.*

Mill was an independent member of Parliament from 1858 to 1868. He used his position to advocate advanced liberal ideas, in particular the suffrage for women and the laboring classes. He also took up the cause of Ireland, favoring a permanent tenure at a fixed rent for Irish tenants, and brought out his ideas on this subject in a pamphlet, entitled *England and Ireland*, published in 1868.

When one turns from Quesnay, Turgot, and Smith directly to Mill, one at once feels that a new era has been entered. The science of economics has lost its youthful simplicity and *naïveté*. It is more elaborated; many parts have acquired an entirely different significance in a new time and under changed circumstances. This corresponds to a changed environment. Manufacturing industry has made gigantic progress by the aid of numerous inventions, as steam power, railways, and a minute division of labor. The laborers are no longer employed chiefly in the country and scattered here and there, as in Turgot's time and particularly in France, but are crowded together in great cities. Manufactures are no longer conducted in small workshops, in which a few journeymen and apprentices labor side by side with the master, but in immense factories, where the capitalist stands at the head of hundreds of human beings. Large establishments begin to crowd out the little man. Population has grown rapidly, and the want of land makes itself felt

Real estate owners take advantage of the situation regardless of the welfare of other classes. While Smith, less than a century before, was able to praise the self-sacrificing generosity of the landlords and farmers or country gentlemen, the power of government is now appealed to for protection against their selfishness.

Nature, too, is viewed in an entirely different manner by Mill. In the time of Turgot and Adam Smith, the physical environment was looked upon optimistically enough as a kind, benevolent power. Jean-Jacques Rousseau had found eager listeners and believers when he preached the doctrine that nature would make all men happy if free course were only given to her laws. Let nature alone, was the cry, and all will be well. In the time of Mill, however, nature is viewed as a hard and heartless power. Civilization is regarded as a struggle to overcome the limitations of the natural environment, and the power of the state is invoked to bring about greater justice and equality than would result from natural forces. There has come the beginning of a reaction against the idea that man is ruled by the environmental forces of nature.

The ***Principles of Political Economy.***— John Stuart Mill's chief writing on Economics, as already stated, appeared in 1848 under the full title of *Principles of Political Economy with Some of Their Applications to Social Philosophy.*[1] Political Economy he defines as a science dealing with "the nature of Wealth, and the laws of its production and distribution: including, directly or remotely, the operation of all the causes by which the condition of mankind, or of any society of human beings, in respect of this universal object of human desire, is made prosperous or the reverse." [2]

Mill was the first among the leaders of English economic thought to adopt an arrangement similar to that now common in our textbooks: his five books being on Production, Distribution, Exchange, Influence of the Progress of Society on Production and Distribution, and The Influence of Government. In this, he follows in part his father and the French expositor of Adam Smith, J. B. Say.[1] He differs from both, however, in abandoning their plan of devoting a distinct book to Consumption, and from Say in adding one on Exchange.

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[1] The book was written during the course of two years. Though it went through seven editions in Mill's lifetime, it was not thoroughly revised and freed from inconsistency. For variation in editions, see article by M. A. Ellis in *Economic Review*, 1906, pp. 291–302; and Ashley's recent edition.

[2] Preliminary Remarks, paragraph 2.

Though Mill added little to economic theory, his formulation of the doctrines of his predecessors, together with certain illustrations and applications, was such that his book was a leading authority throughout most of the second half of the nineteenth century. It is, therefore, fitting to discuss the essentials of his teaching.

In his introduction, he defines "wealth" and distinguishes national or social wealth from individual wealth; attacks Mercantilistic ideas; passes in rapid review the various economic stages of society as he sees them; refers to the great inequalities in wealth among different countries, which are partly due to the laws of production (which are natural and not arbitrary), and partly to laws of distribution (which are largely influenced by human institution, and are arbitrary). "The laws of Production and Distribution, and some of the practical consequences deducible from them, are the subject of the following treatise."

He takes wealth to be "All useful or agreeable things which possess exchangeable value," and adds that essential qualities are susceptibility to accumulation and a material nature. He would personally have preferred to make "durability" a test, rather than material nature; and he both argues against a "transferability" test, and favors including human skill. But the Classical concept was accepted on grounds of expediency.

Value. — Without any attempt to develop his ideas in the order he adopted, what Mill himself called a fundamental question, namely value, may at once be taken up.

In answering this question, he immediately introduces the reader to a threefold classification of commodities. In the first class, fall those which are absolutely limited in supply, and are not increasable at pleasure, as, for instance, rare pictures. Here, too, for short periods of time, Mill includes labor, articles of international trade, and all cases of monopoly.

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[1] For discussion of this subject see Cannan, *Production and Distribution*, pp. 32 ff.

In this first class, value depends upon demand and supply: "the value which a commodity will bring in any market is no other than the value which, in that market, gives a demand just sufficient to carry off the existing or expected supply." [1] Mill states that by demand we must mean "effective" demand, and to make demand and supply comparable, he takes them to mean the quantity demanded and the quantity supplied. As his "law of demand and supply" applies without modification to this class alone, it is important to ascertain what this law is. "The law is, that the demand for a commodity varies with its value, and that the value adjusts itself so that the demand shall be equal to the supply." [2] And it was Mill's idea that where cost of production enters — as, he argues, it does not in this first class — another law controls.

Assuming, as Mill does, a certain value to begin with, his statement of the law does not satisfy one who desires to know the cause of value. It lacks an analysis of the sources of demand.[3] The recognition of the interrelation of demand and supply suggested, however, seems worthy of note.

But this first class of commodities Mill held to be of relatively little importance in the theory of value. The great majority come under his second class: commodities which, being the result of "labor and expenditure," can be increased in indefinite quantity. Here Mill distinguishes natural (normal) and market values, and desires to find a law other than that of demand and supply for the regulation of the former, — of "permanent or average values." At any given time, demand and supply determine market value, and they always rule its oscillations. But, where goods are producible, there is a minimum point set by cost of production; and, if they can be indefinitely multiplied, the minimum is also a maximum.[1] This is the normal value point. Goods whose costs of production are the same must normally have the same exchange value. In class two, then, there is "a superior force which makes value gravitate towards cost of Production," [2] — the tendency of supply to increase to the point of lowest profitable production. To put it in another way, there is a "latent influence" which makes values conform in the long run to the cost of production. This is the variation which would otherwise take place in supply: if a good were to sell above the "ratio of its cost of production," its supply would increase, and *vice versa.*

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[1] Bk. III, Chap. II, § 4.

[2] *Ibid.*, Chap. IX, § 3.

[3] Jevons criticized Mill's theory as follows: "It [Mr. Mill's equation] consists in stating that the quantity x given by A is equal to the quantity x received by B. But this must necessarily be the case if any exchange takes place at all. The theory of value, as expounded by Mr. Mill, fails to reach the root of the matter, and show how the amount of demand or supply is caused to vary." (*Theory of Political Economy*, 1871, p. 102.)

Thus the value of reproducible commodities does not depend on mere demand and supply, except when there is disturbance, and pending the adjustment of supply to demand.

This is clearly an undue emphasis of supply. Supply is spoken of almost as a metaphysical entity. The influence of variation in demand is slighted. In case of a fluctuation, for example, the *modus operandi* runs thus: (1) "Natural" (normal) value equals cost of production plus profits; (2) there is a certain demand for a certain quantity at this value; (3) to this demand the supply endeavors to conform, — "the permanent tendency of supply is to conform itself to the demand which is found by experience to exist for the commodity when selling at its normal value."

But what are costs of production? Mill inclines, though not consistently, to take the entrepreneur's point of view, and includes wages and usual profits. In this, he accepts Senior's analysis. He agrees with Ricardo so far as to say that the relative value of commodities depends principally on the quantity of labor,[1] and that in variations of value the quantity of labor is most important; [2] but insists that quantity and remuneration must both be considered. As to rent, with certain minor exceptions, he considers that it is not a part of costs.

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[1] Bk. III, Chap. III, § 2. Free competition assumed.

[2] *Ibid.*, last paragraph.

Concerning the third class of commodities, — those which, like agricultural produce, may be increased in supply indefinitely, but only by a more than proportionate increase in cost, — Mill says little. (And a discussion of the significance of increasing returns to value, will be sought for in vain.) This class stands midway between the others, value being determined at the point where costs of producing the needed supply are greatest.

Mill's was an objective exchange theory. Cost of production, working through supply, was the basis of it. But it was not a labor-cost theory; and he made several exceptions to cost determination, so as to cover cases in which custom restricts markets, or costs are joint. Its great weakness lies in the absence of analysis of the forces lying back of demand and supply, a difficulty which a follower meets by introducing demand price schedules and supply price schedules.[3]

The Shares in Distribution in a Static Society. — As to the determination of rent, Mill was substantially in accord with Ricardo. The rent which any land will yield with a given employment of capital is the excess of its produce, beyond what would be returned to the same capital if employed on the worst land in cultivation, situation being considered. Even if all land yielded rent, there would always be an intensive margin, and some agricultural capital which paid no rent.

Mill suggests, however, that in cases where there is an alternative use, or "scarcity values" exist, rent may enter price.[4]

He often regards the landowner somewhat as did Adam Smith: his "exclusive power" over natural agencies is emphasized;

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[1] *Ibid.*, Chap. IV, § 1.

[2] Bk. III, Chap. IV, § 3.

[3] Marshall, *Principles of Economics.*

[4] For a discussion and criticism see Haney, "Rent and Price: 'Alternative Uses' and 'Scarcity Value,'" *Quart. Jr. Econ.*, XXIV (November, 1910).

"rent is the effect of a monopoly" and "the reason why landowners are able to require rent for their land, is that it is a commodity which many want, and which no one can obtain but from them." But, again, perhaps with his mind on Senior, he states that the landowner has no true monopoly, inasmuch as any one may buy land. Mill does not so strongly assert that the interests of the landowner are opposed to those of society as did Ricardo, but he emphasizes the point that "the interest of the landlord is decidedly hostile to the sudden and general introduction of agricultural improvements." [1]

Wages are determined according to a sort of devitalized wages-fund doctrine. In ordinary circumstances, he says, we may speak of wages as being determined by competition, or the forces of demand and supply with reference to labor. This may be expressed as the proportion between population and capital, if we understand by population only those who receive wages, and by capital that devoted to wage payment! Such capital consists, Mill says, of that part of circulating capital paid in wages, and funds paid to soldiers, servants, and other "unproductive" laborers. Obviously this statement of the case is little more than a mere truism.

There is little direct evidence in the *Principles of Political Economy* that Mill held to the idea of a rigid wages fund. A few passages indicate such an idea,[2] but it was not carefully analyzed, nor were its consequences thoroughly understood. Probably he would not have defended it so far as the long run is concerned. But he thought a rise of wages in one trade would necessarily mean an immediate deterioration in some other, and that some time must elapse before an adjustment could take place.[3] Later, in 1869, under criticism by Longe and Thornton, Mill made his celebrated recantation of the wages-fund idea.[4]

In connection with Mill's use of the wages-fund idea, his belief in the Malthusian principle of population should be recalled. This principle he strongly emphasized, and his discussion of wages is influenced, no doubt, by a desire to show that, according to the fund idea, a limitation of population is practically necessary if better wages are to be obtained.

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[1] Bk. IV, Chap. III, § 4.

[2] Bk. I, Chap. V, § 9; and notably Bk. II, Chap. XII, § 1, last paragraph.

[3] *Political Economy*, Bk. V, Chap. X, § 5.

[4] For discussion of this whole subject, together with some justification of a wages-fund theory, see Taussig, *Wages and Capital*.

Profits are closely related to wages. Mill cites Senior's abstinence idea [1] with approval, and then explains that abstinence is but a part of the cost covered by "gross profits." Besides interest, which is the usual name for that part of profits received for abstinence, "gross profits" includes wages of superintendence and indemnity for risk: it is the entrepreneur-capitalist's net income, — his surplus after paying wages. Mill states that no practical error results from disregarding rent in this case.

The amount of the entrepreneur-capitalist's gross produce depends upon the productive power of labor. From this, he makes advances in the shape of wages.[2] The *rate* of profit, then, depends on the proportion of the produce of labor obtained by the laborers themselves. "We thus arrive at the conclusion of Ricardo and others, that the rate of profits depends upon wages; rising as wages fall, and falling as wages rise." [3]

Mill, however, would modify this formula to the slight extent of substituting the phrase "cost of labor" for "wages," his ground being that real wages is only one of several factors determining the employer's "advances," the others being the price of subsistence and the efficiency of labor. To the capitalist, cost of production is not labor, but wages, "and since wages may be either greater or less, the quantity of labour being the same, it would seem that the value of the product cannot be determined solely by the quantity of labour, but by the quantity together with the remuneration; and that values must partly depend on wages."[1]

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[1] See above, p. 345.

[2] "But materials and implements are produced by labour; . . . in the whole process of production, beginning with the materials and tools and ending with the finished product, all the advances have consisted of nothing but wages; except that certain of the capitalists concerned have, for the sake of general convenience, had their share of profit paid to them before the operation was completed. Whatever, of the ultimate product, is not profit, is repayment of wages." (Bk. II, Chap. XV, § 5.)

[3] Bk. II, Chap. XV, § 6.

In his discussion of profits, Mill shows some traces of an influence by Senior; but, on the whole, his thought is based on Ricardo. He generally regards capital as advances to laborers, chiefly in the shape of food or sums for purchasing food. Though he explicitly places capital with labor and land as a factor in production, he reduces it to stored-up labor in resolving all expenses into wages, and his recognition of its distinctness as a factor in production, is at times halting. This is inconsistent with his recognition of the abstinence basis for profits.

In a word, here is found an illustration of Mill's imperfect fusing of diverse ideas. If Mill had taken Senior's suggestion and treated interest separately, not trying to lump it together with insurance, and especially with wages of superintendence, progress might have been made. He was, however, too much under the influence of his early training in Smith and Ricardo.[2]

The foregoing comprises the chief points in Mill's theory of value and distribution. Aside from exposition and illustration, he adds little to the framework of economic theory. His treatment of value is in advance of Ricardo's, however, and his discussion of the relation of wages to profits, while weak, is also an improvement.

Consumption and Production. — On the relation of consumption to production, there was much confusion in the Classical economics, and Mill was no exception to the rule.

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[1] Bk. III, Chap. IV, § 2.

[2] Böhm-Bawerk is astray in stating that Mill gives three inconsistent answers to the question, "whence comes profit?" (*Capital and Interest*, Smart's translation, p. 408.) Böhm-Bawerk fails to distinguish between possibility and necessity. Mill would not have thought of calling his admission of productivity to capital a "theory." Productivity, like utility in value, makes a return possible; but what "determines"? This was the question. The other was assumed. Mill consistently holds that the interest element in "gross profits" is payment for cost of abstinence. This makes a certain payment *necessary*. As to Böhm-Bawerk's discovery of an exploitation theory in Mill, it is illusory. He does not note the distinction between replacement and reward. As the result of a round of production (Mill's statement in this passage is incomplete in imputing production to labor alone) the advances of the capitalist are more than replaced, thus making possible a reward for abstinence. On this point see Bk. II, Chap. II, § 1.

He denied a distinct place to consumption, and gave no book or chapter to the subject. "Utility," which was so important in the development of subsequent theories of consumption and value, he was content to leave with a sweeping general recognition that it is essential to exchange value. It is in connection with his treatment of capital and the wages fund, however, that the confusion just referred to is most apparent; for here Mill attempts to prove the "theorem"[1] that "demand for commodities does not in any manner constitute a demand for labour."[2] His idea at this point is that the demand for labor is constituted by capital — the wages fund — and that a change in consumption only modifies the direction of this already existing demand; and through several pages, he struggles and twists and turns in the vain effort to disprove the simple fact that wants form the mainspring of economics and that the intensity and variety of consumers' demands act effectively upon production and wages.[3] In fact, the payment of wages itself may be regarded as buying the utilities produced in part, at least, by labor.

In a notable chapter on Excess of Supply, which appears in his book on Exchange, Mill expounds some other phases of the relation of consumption to production that he had pointed out in his *Essays*. He argues that, contrary to the belief of Malthus, Chalmers, and Sismondi, a general oversupply or glut is impossible. Partial gluts exist, and may temporarily become general. In the latter event, however, the situation is not due to oversupply, but to an excess of speculation leading to a collapse of credit. In this, he follows Say and his father, James Mill; but his development of the doctrine is an addition to the Ricardian scheme.

International Trade. — Another contribution of Mill's was his development of the Ricardian theory of international trade, and especially its value aspect.[1] Following Ricardo, his conclusion was that it is not difference in absolute costs of production, but in comparative costs, which determines international exchange. If English cloth and corn both cost 150 days' labor, and Polish cloth and corn both cost 100 days' labor, there will be no exchange; but if England's corn cost 200 days' labor, it will pay her to buy that commodity from Poland.

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[1] "Truth," before 3d ed.

[2] *Principles*, Bk. I, Chap. V, § 9.

[3] But Mill himself says (Bk. I, Chap. X, § 1) that production is "stimulated not only by the desire of the producers to augment their means of consumption, but by the increasing number of the consumers." It appears to be a mistaken idea of capital, its importance and relation to wages, that led him into error.

All this was substantially Ricardo's doctrine. But Mill went further than his predecessor in reasoning that the law that permanent value is determined by cost of production does not hold for foreign commodities. Capital does not move readily from one nation to another; but may remain in a country having no advantages in production, and cause foreign trade to exist. The value of foreign commodities depends rather upon the cost of producing the goods exchanged for them,[2] that is, upon demand. In other words, international values obey a law of "equation of international demand": "There is some proportion at which the demand of the two countries for each other's products will exactly correspond; so that the thing supplied . . . will be completely paid for, and no more. . . ."[3] "Supply and demand are," in this case, "but another expression for reciprocal demand."

In the third edition of the *Principles,* Mill comes to the conclusion that his theory is incomplete, in that the equation of international exchange might have its conditions fulfilled by many different rates of exchange. The *rate* at which international values become adjusted, remained indeterminate in his reciprocal demand theory. To supply the deficiency, he concludes that it is necessary to take into consideration supply conditions, or, as he puts it, "the extent of the means of supplying that demand which are set at liberty in each country by the change in the direction of its industry." After some floundering, we are given as a final result the statement that the improvement in his theory "does not seem to make any very material difference in the practical result"!

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[1] This was chiefly done in the first of his *Essays on Some Unsettled Questions of Political Economy* (published 1844), but further contributions were made in the third edition of the *Principles* (1852). Mill's chief dogmatic contributions appear in these essays. The subject is treated in Bk. III, Chaps. XVII and XVIII, of the *Principles.*

[2] Mill here means, not entrepreneurs' outlays, but real costs.

[3] Bk. III, Chap. XVIII, § 5.

In criticism of Mill's idea of international value, one notes that he is wrong in believing that, in any ultimate sense, the cost of production in the other country does not enter,— as he dimly perceived by the time of his third edition. If the cost of the things exported be taken to enter, the question remains, "what determines *how much* must be exported?" As elsewhere, Mill here shows the undigested character of his theory as a whole. He ~~does~~ not bring his reasoning sufficiently into relation with his general theory of value. He makes a difference in degree appear as though it were one in kind.

Mill points out admirably the various advantages flowing from an extended international trade, the saving in prices to consumers being the great point. Accordingly, certain "vulgar" Mercantilistic notions, namely that a market for surplus products exported is the benefit, and that the national gain from commerce comes in the shape of profits to merchants, are disposed of. In this connection, Adam Smith is criticized as not being entirely free from error.

By introducing the law of supply and demand into the field of international values, Mill furnished ground for new protectionist arguments, and he himself pointed out that taxes on imports and exports might be so adjusted as to force the former to bear them at least in part. Mill, however, was far from being himself an advocate of protection.

The Influence of Progress on Distribution in Dynamic Society. —In Book IV, Mill treats of the Dynamics of Distribution. He contributes little to Ricardo's ideas, in so far as economic principles are concerned, but it is here that he most plainly shows the influence of Comte. After describing the elements of industrial progress, — invention, security, business capacity, united action, and other factors which give man greater control over nature, — he proceeds to show (1) that prices of agricultural produce tend to rise, while (2) a perpetual tendency to increase the productive power of labor in manufactures causes manufactured articles to fall in price. Thus the rent of land increases; money wages rise; the rate of profits falls.

In spite of industrial progress, the increase of laborers is ordinarily such that a greater population is enabled to live the same life of drudgery and imprisonment. "Only when, in addition to just institutions, the increase of mankind shall be under the deliberate guidance of a judicious foresight, can the conquests made from the powers of nature . . . become the common property of the species. . . ." [1]

In the last chapter in Book IV, "On the Probable Futurity of the Laboring Classes," he wishes to fix attention upon improvement in distribution and a larger remuneration of labor, as the desiderata.[2] These ends may be achieved by a voluntary control of population arising with better education and the opening of employment to women, and by "a more and more complete realization of the ends which Socialism aims at, not neglecting its means so far as they can be employed with advantage." [3] He advocates "organization of industry" along the lines of LeClaire's profit-sharing plan.

Mill held that, ultimately, in spite of unlimited progress in the arts, a stationary state must be reached. In such a state, increase in material production and in population would be at a stand. Another result would be a minimum rate of profits; and one of the most interesting points in the *Principles* is the discussion of the "tendency of profits to a minimum."

Why? What minimum? When? one asks. Mill argues that were it not for the opening of new outlets, the expansion of capital which accompanies the progressive state would soon reach a limit, and capital receive the rate which would be the lowest that would induce people to accumulate savings and employ them productively. Two forces cause this expansion: a diminution of risk, and increase in providence. Accordingly, "when a country has long possessed a large production, and a large net income to make savings from, . . . it is one of the characteristics of such a country that the rate of profit is habitually within, as it were, a hand's breadth of the minimum."[1]

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[1] Bk. IV, Chap. VI, last paragraph.

[2] It is to be remembered that this chapter was largely affected by his wife and by his later interest in radical social reform. On the whole, its tone is very different from the main body of the work, which was drawn from Ricardian thought, somewhat influenced by Comte. It might almost be regarded as a sort of appendix inserted in his hastily written volume.

[3] § 5.

So far, this idea of a stationary state and minimum profits might have come from the *Wealth of Nations*. Mill's reasoning, however, is not based on a mere competition among capitals, but on the Ricardian ground. As capital increases, the number of laborers would or would not increase. If it did, poorer investments of agricultural capital would become necessary; the price of subsistence would rise; so with money wages; and, as a result, the rate of profits would fall. If population did not increase, there would be a greater capital to divide among laborers, and wages would rise, with the same result.

This last conclusion is based upon the assumption that even if "capital" were to increase, "there would not be any increase of the produce,"— an assumption possible only if by increase in capital is meant wages-fund capital in the shape of subsistence. This assumption appears quite unreasonable when Mill's own emphasis of invention and "comity of action" are recalled.

Mill on the "Social Question." — A point has now been reached at which Mill's views on what may be called the Social Problem may well be discussed.[2]

Two questions are to be answered. What is the problem contained in the Social Question? What is the office of government in respect to its solution? This problem, perhaps the weightiest of our time, is also an important one in connection with political economy. But it is the same problem as that of utilitarianism. Without understanding Mill's utilitarian principles, it is quite impossible to comprehend his political economy. In his utilitarianism alone, is unity to be found in Mill, — a unity of purpose.

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[1] Bk. IV, Chap. IV, § 4. Mill excepts countries having large reserves of land.

[2] Lange, *J. S. Mill's Ansichten über die sociale Frage.*

What, then, is the problem of utilitarianism?[1] It is to increase the entire sum total of human happiness. Happiness, in the broadest utilitarianism, includes all elements of well-being: the greatest amount of material wealth, still more of physical, spiritual, and ~~moral~~ welfare, ~~associated with the~~ least possible suffering, — the same problem which confronts us in the social question. That does not mean either the happiness of laborers alone or the happiness of the upper classes alone. If a renunciation of pleasure on the part of one class brings with it an increase in the total amount of happiness, this renunciation is justified, and ultimately so, even if it be a compulsory renunciation. Not the present alone, however, but, so far as we can judge beforehand, the entire future, is to be taken into consideration. If it be proved, or if it be probable, that private property will in the end contribute to the happiness of mankind, this institution is to be maintained on that account.

This seems to be Mill's belief, or rather it is the belief which he expresses in his political economy. As already noticed, Mill's belief underwent a change in later life; and to make the matter of his final opinions still more uncertain, it is mentioned in one place in his *Autobiography*, that he did not always speak out his whole mind, but only said what he thought the public could bear. The passage referred to is this: "In the *Principles of Political Economy* these opinions [on Socialism] were promulgated, less clearly and fully in the first edition, rather more so in the second, quite unequivocally in the third. The difference arose partly from the change of times, the first edition having been written and sent to press before the French Revolution of 1848, after which ~~the public mind became more open~~ to the reception of novelties in opinion, and doctrines appeared moderate which would have been thought very startling a short time before. In the first edition the difficulties of Socialism were stated so strongly that the tone was on the whole that of opposition to it. In the year or two which followed, much time was given to the study of the best Socialistic writers on the Continent, and to meditation and discussion on the whole range of topics involved in the controversy; and the result was that most of what had been written on the subject in the first edition was cancelled, and replaced by arguments and reflections which represent a more advanced opinion."

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[1] See above, p. 249.

Mill's final judgment with regard to Socialism appears to be that, however valuable as an ideal, or even as a prophecy of ultimate possibilities, it "is not available as a present resource, since it requires from those who are to carry on the new order of things qualities both moral and intellectual, which require to be tested in all, and to be created in most." [1]

As already indicated, the whole question of private property, according to Mill, is at bottom one of utility. If Communism could be shown to minister to the happiness of society as a whole better than the system of private property now in vogue, it ought to be adopted. Which system carries with it the greater amount of total net happiness? The answer to this question is the solution of the problem. To be considered are historical experiences, all motives which have influenced and which might influence men under different social systems, all effects of society on the individual and of the individual on society, and a host of facts and forces. The calculation of probabilities is always difficult, but nowhere more so than in this case.

Now in the discussion of the social question, the theory of population plays an important rôle, and a pause must be made here to consider Mill's position in regard to Malthusianism.

Mill accepts the doctrine of Malthus, substantially as he found it taught in the writings of the latter. He agrees with Malthus in the doctrine of preventive and positive checks to population, but goes farther than Malthus did in the advocacy of preventive checks. Indeed, Mill gives a larger place to the principle of population than any other economist of his day. This fact is partly to be explained by his strong feeling that women were abused under the existing system. He dwells particularly upon the sin of calling human beings into the world without having the means to support them. He wishes to strengthen the feeling of responsibility in parents, and to spread among the people an understanding of the consequences of overpopulation. "Poverty, like most social evils," says he, "exists because men follow their brute instincts, without due consideration. But society is possible precisely because man is not necessarily a brute."

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[1] Rough draft of projected work on Socialism published in *Fortnightly Review*, 1879.

A little farther on, he makes use of this strong language: "Little improvement can be expected in morality, until the producing of large families is regarded with the same feelings as drunkenness or any other physical excess. But while the aristocracy and clergy are foremost to set the example of this kind of incontinence, what can be expected from the poor? . . . One would imagine that children rained down on married people direct from heaven; that it was really, as the common phrases have it, God's will and not their own, which decided the number of their offspring." [1]

It is, then, clear that above all things legislation must not weaken the feeling of responsibility in begetting children, but must strengthen it. In connection herewith, Mill explains the ground of his objection to a legal minimum of wages. It would remove all the barriers which now oppose overpopulation, until finally this world with its human race would resemble a great ant-hill or a beaver colony. Such an interference of the state would, therefore, be productive of harm only.

It must not be imagined that Mill had *a priori* objections to such interference of government. If the matter concerned the present generation only, he maintains that it would be possible to employ all, and to establish a minimum of wages. "Society mainly consists," he says, "of those who live by bodily labor, and if society, that is, if the laborers" (is this an identification of laborers and society?) "lend their physical force to protect individuals in the enjoyment of superfluities, they are entitled to do so, and have always done so, with the reservation of a power to tax those superfluities for purposes of public utility; among which purposes the subsistence of the people is the foremost. Since no one is responsible for having been born, no pecuniary sacrifice is too great to be made by those who have more than enough, for the purpose of securing enough for all persons already in existence. But it is another thing altogether, when those who have produced and accumulated are called upon to abstain from consuming, until they have given food and clothing, not only to all who now exist, but to all whom these or their descendants may think fit to call into existence." That would, according to Mill, as already stated, reduce us to the condition of ants in an ant-hill.

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[1] Bk. II, Chap. XIII, § 1.

But the state has by no means solved the social problem, when it has found means to prevent starvation. A rise of wages is not occasioned thereby, nor a fall of wages prevented. The purpose aimed at is higher wages, since, according to Mill, the present condition of affairs is intolerable.

Passages have been quoted indicating that Mill would prefer Communism to an unimproved continuance of our present system. But the choice does not lie between Communism and the continuance of our present system without improvement, inasmuch as it is possible to better the actual condition of things. The first measure to be introduced is universal education. The laborers lack the means and the will to provide for the education of their class; the state must care for the schools. The instruction provided by the state should be thoroughly practical in its character, aiming to develop sound common sense, good judgment, and an understanding of surrounding circumstances.

Besides schools, a participation in political affairs is an important and necessary means of educating the people. Every adult should have the right of suffrage, under the sole condition of demonstrating that he has improved the advantages of education offered him. Taking an active part in politics is the first thing in modern times which accustoms the mind to more extended interests and views than those merely personal, the first step taken outside of individual and family selfishness.[1]

Among the poorer, as among the higher, classes, the concept of a proper standard of life would be formed, and the increase of population would be limited thereby. Besides, if public opinion were once far enough advanced to allow it, legislation could make it a legal offense for one to beget children without having the means to support them.[2] But Mill thinks that such a law would be unnecessary, if only women were emancipated "so that they should not depend for their living upon the exercise of a single physical function." Becoming more independent, they would not submit to the burden of large families.[3]

At least two measures are suggested by which the government may permanently improve the condition of laborers: by extensive colonization according to Wakefield's system;[4] and by the sale of public land to the industrious poor, thus forming a class of small proprietors. The laws, too, ought to favor associations of laborers, coöperative undertakings, and voluntary communistic experiments.

Mill also recommended various measures to encourage improvements on land, small holdings, and the cultivation of waste lands. He thought that it might be advisable for the state itself to own land and lease it to coöperative agricultural associations, or, in small portions, to individual farmers.

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[1] *Dissertations and Discussions*, Vol. III, "Thoughts on Parliamentary Reform." The German economist, J. H. von Thünen, demanded universal education as essential to the economic progress of the labor class much earlier than Mill, but was oversanguine as to the possibility of truly educating people in poverty. *Der isolirte Staat in Beziehung auf Landwirthschaft und Nationalökonomie*, II Theil, I Abtheilung, "Ueber das Loos der Arbeiter, ein Traum ernster Inhalts," S. 41 u.s.w.

[2] *Principles*, Bk. II, Chap. III, § 2.

[3] *Dissertations and Discussions*, Vol. II, pp. 411–449; "Enfranchisement of Women."

[4] E.g., Wakefield, *View of the Art of Colonization*, 1849. Proceeding from the idea that the highest productiveness of industry depends on a proper proportion of labor to land, Wakefield proposed that the government reserve unappropriated lands in the colonies, putting a higher price upon them than prevailed in the market, so as to prevent too hasty and extensive acquisitions. The proceeds were to be used for assisting the emigration of laborers to the colonies.

The fact that land is limited both in quantity and quality gives government a function to exercise respecting it. The right of property, which one enjoys in the fruits of one's labor, exists only by support of the authority of society; and this support can be withdrawn. Now if the right of property in that which one has created is of this nature, how much more dependent must be the right of property in land, which nature, not man, created. Here private property is justified only if landlords make those improvements which benefit society.[1] The state should invariably reserve and exercise the right to interfere when the public good demands it. The single fact that the land supply is limited, gives government this right, which it ought to have in case of all monopolies.[2]

The Unearned Increment. — Mill was the first to use the term "unearned advantage" [3] in connection with land, a term since become so significant as "unearned increment." The basis for the idea is laid by Smith and Ricardo in their treatment of taxes on rent, but they do not advocate any absorption of economic rent as an unearned increment. Mill favored a periodical valuation of land by the government, with the object of enabling it to take over the difference in value, — the "spontaneous increase" which had accrued to rent.[4] He assumed that there would be a rise in value, due to social forces, not to improvements by landlords.

The foregoing account of some of Mill's views as to private property and the social question is based upon his *Principles of Political Economy*, or earlier essays. Mill later avowed himself a Socialist [5] in a qualified and conservative sense of the term. While he looked forward to a time when individual liberty might be combined with common ownership of raw materials and equal participation in the "benefits of combined labor," he repudiated that tyranny of society over the individual which Socialistic systems were "supposed to involve."

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[1] *Principles*, Bk. II, Chap. II, § 6; *Dissertations and Discussions*, Vol. IV, "Explanatory Statement of the Programme of the Land Tenure Reform Association."

[2] *Dissertations and Discussions*, Vol. IV, "The Right of Property in Land."

[3] First used in third edition (1852); "unearned appendage," "increment of rent," in earlier editions.

[4] *Principles*, Bk. V, Chap. II, § 5; *Dissertations and Discussions*, Vol. IV, "Land Tenure."

[5] *Autobiography*, pp. 230–234.

Governmental Interference; ***Laisser Faire.*** — Thus far, the interference of government in economic affairs has been but incidentally mentioned. Further attention, however, should be directed to Mill's statement of the "rights" of governments and individuals, and the limitations upon them, for it has become a classic.[1]

Government interference, according to Mill, should be limited by *a general right of citizens to their individuality*, in so far as such a right is not injurious to others, — if I do not injure my fellows, I may be or think as I choose. "All restraint, qua restraint, is an evil." And a point greatly emphasized, is that *a large degree of individual initiative is desirable as a means of education.*[2]

He also considers that division of labor may be unduly restricted by the inability of the government to do all things, there being limitations upon its activity which do not obtain in the case of its individual members. This limitation might be more or less overcome by a greater division in administrative function; but, on the whole, Mill thinks that private activity is generally better and cheaper, as is shown by the fact that the government is seldom able to compete with private individuals.

Like his Classical predecessors, Mill held that the individual has both a greater knowledge of his own feelings and circumstances, and more interest in his own well-being, than any one else. Accordingly, individual initiative is desirable except when it harms other individuals, or impedes their efforts to obtain their own good.

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[1] *Principles*, Bk. V, Chap. XI.

[2] It is to be noted, however, that this point may sometimes have an opposite bearing. For example, an argument for municipal ownership is that the people would take interest in municipal affairs, economic and otherwise.

An objection to all acts of governmental interference lies in the increased influence thus obtained by the state. This is always dangerous, but nowhere more so than in a democracy. Individuality, a rich diversity of human development, is a source of all progress, and should be jealously defended.[1] In his essay *On Liberty*, Mill also portrays vividly the dangers of bureaucracy, showing how it substitutes routine for progressiveness, and, being insufficiently subject to criticism, rushes into ill-advised crudities of policy.

"*Laisser faire*, in short, should be the general practice; every departure from it, unless required by some great good, is a certain evil."

But Mill allows a great place for government activity. Utility is the only test: if the greatest good of the greatest number is thereby conserved, let the government step in. He distinguishes two great classes of interference, according to method: "Authoritative," in which the government says, "do this," or "do not do that", "Non-authoritative," or optional, as when the government merely spreads information, establishes models, and the like. The burden of proof rests heavily upon those who advocate the former; the latter is less open to objection.

More specifically, Mill would permit government action in cases in which it is required by the interests of consumers who are unable to help themselves. Here the competition of the market does not apply. The matter of schools, for instance, cannot be left to the judgment of individuals. In the interest of the incompetent, as the insane; of those under a personal contract in perpetuity, as married women; and of those who have but an indirect control over their property, as investors in joint stock companies, governments may properly interfere. Similarly, where people are acting for others, and are not properly guided by self-interest, as in the administration of charity, and in such public service as erecting lighthouses or conducting scientific experiments, there is room for public activity.

In the foregoing cases, Mill is substantially in accord with

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[1] *Principles*, Bk. V, Chap. XI, § 3; *On Liberty*, Chap. III.

Adam Smith,[1] except that he gives a much broader application to the principle of interference in behalf of the consumer, as such. But he goes much further when he says: "There are matters in which the interference of law is required, not to overrule the judgment of individuals respecting their own interest, but to give effect to that judgment; they being unable to give effect to it except by concert, which concert again cannot be effectual unless it receives validity and sanction from the law." [2] According to this principle, Mill would, under certain conditions, justify such measures as the legal establishment of a nine-hour day, and public administration of colonization schemes.

Comparing these two great English economists, one conclusion is that the difference in their opinions is associated with the difference in the extent to which utility was given rein: Smith's belief in "natural law" forbade the immediate application of the principle of utility, and made his application of *laisser faire* more absolute than Mill's. Mill was not committed to individualism as an absolute generalization. The influence of Bentham's thought is thus apparent. Doubtless, too, this difference was in no small measure due to the industrial evolution that had intervened. Just as Mill could say that his argument did not apply to private corporations, though now they are the dominant form of business organization; so by Mill's day, what had seemed to Smith the exception had in some cases become the rule.

Philosophy and Method. — In studying Adam Smith, it was found that though there was a utilitarian element in his political economy, this was largely concealed by a rather transparent veil of "natural right." In Mill, this veil is dropped altogether, and utilitarianism comes forward openly as such. If any course of action has maximum utility, nothing further is to be said against it. But perhaps enough has been written already on this matter.

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[1] Cf. above, pp. 229 f.

[2] *Principles*, Bk. V, Chap. XI, § 12.

Mill distinguishes between different kinds or grades of utility (happiness), and assigns a far higher rank to those utilities which benefit the mind than to those which benefit only the animal body. One must not, therefore, accuse Mill of materialism or of selfish principles, merely on the ground that he professed himself a utilitarian.

In fact, Mill — the Mill of later years, at least — may be classed as an idealist. Here his inconsistency, resulting from change and growth, makes it difficult to judge. His economics proper, especially his statics, based as it was upon Ricardo, is essentially materialistic. To this extent, man is regarded as the creature of physical laws, and utility is a material concept. Wealth is material, and Mill even suggests including personal skill. But where he preaches, where he discusses progress, where he inconsistently with the Benthamic utilitarianism distinguishes different grades of happiness, there he is the idealist. There the influence of Comte's philosophy, of the Socialists, and of his wife, modify the Ricardian foundation. Man dominates nature. Utility includes happiness of a high order.

It is one aspect of Mill's idealism that shows itself in his differentiation of the laws of Production from those of Distribution.[1] In the former, nature is supreme, and her action is to be accepted without question. Her facts are physical truths. Man merely moves things so that they will be acted upon by her forces. But in Distribution, human institutions dominate. Here laws are not unalterable; nor are the things that are, the best that can be. Led by his idealism, Mill made this change in the simpler Ricardian creed, based as that was upon a "primitive economy." [2]

As is usually the case with idealists, Mill was essentially an optimist, and among his last words we find this statement: "The evils and injustices suffered under the present system are great, but they are not increasing; on the contrary, the general tendency is toward their slow diminution."

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[1] Patten, S. N., *Dynamic Economics*, p. 21.

[2] *Principles*, Bk. II, Chap. I, § 1; Preliminary Remarks, last four paragraphs.

No doubt, too, there is to be seen in all this, the working of the changed conditions mentioned in the introduction to this chapter. Many great inventions made social readjustments necessary. The growth of population, and the acceptance of the Malthusian principle, suggested the need for and possibility of human control and improvement. Mill first accepts social institutions as well as physical laws as a controlling force, and then argues for a progress, not merely quantitative, but qualitative, through social action.

This invocation of social activity is an ear-mark of Idealism. Mill, however, draws too sharp a distinction between the laws of Production and Distribution, nor is he able to carry it out consistently.[1] The pillars or foundations of his economic theory remain materialistic. "A primitive man," moved by self-interest, "is put into the mechanism of modern society." In thus asking a primitive man — one actuated by self-interest and molded by physical environment — to progress along lofty social lines, he again shows that same lack of harmony or synthesis between mind and matter — man and environment — individual and society — which has been observed in so many other economists.

We find in Mill's thought, on the one hand, a strong adherence to the old *laisser-faire* principles; on the other, a recognition of the evils developed by a later time, and a decisive declaration that individualistic egoism is not sufficient to work a cure. We find even some approach to the opposite of *laisser faire*, Socialism, in those parts of his work which deal with the labor question. "Extremes meet." Whether judged from the standpoint of the individualist or of the Socialist, Mill's system appears inconsistent. Notwithstanding the admirable acuteness and clearness of his understanding, he appears to have become confused between the old and the new times. His system may be compared to a Janus head, of which the one face looks back into the past, the other forward into the future. Or he may be likened to a man standing at a place where two parallel roads diverge, without being able to decide which one to take.

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[1] See, e.g., Bonar, *Philosophy and Political Economy*, p. 252.

Mill's method is to be criticized on lines similar to those followed in examining his philosophy. In his earlier work, he regarded the *a priori* and deductive method as the only fruitful one for a study of first causes. His *Unsettled Questions* shows a belief in this method, not only for Political Economy, but for the broader Social Science. He began his *System of Logic* with the idea, more or less conscious, of establishing the reign of law in society as in the physical world, and showing that the *a priori* methods of Ricardo and James Mill were the same as those used in the "natural sciences." [1]

Even while at work on the *Logic*, he was corresponding with Comte,[2] and the latter's influence, together with that of Macaulay and a study of chemistry, led him to modify his belief. For social science, he was led to believe that the old method was dangerous, and to advocate a combination of induction and deduction which he called the Concrete Deductive Method. This method, it will be observed, would readily appeal to one grounded in the Ricardian law of Rent, which is "a plain induction, followed by a bold deduction with plenty of verifications."

This much may be said: Mill went further than any great English economist preceding him, in *expressly* using perfect competition as a hypothetical assumption, made only for scientific purposes, and in pointing out exceptions and limitations

The framework and foundation of the *Political Economy*, however, remain *a priori*. He sets out with the same suppositions that underlie the thoughts of Adam Smith and Ricardo, namely, that man is governed by self-interest in economic affairs, that the individual's pursuit of his own ends promotes the general welfare, that profits and wages are equalized by competition, and that taxation is shifted about in such manner as to make them so. Only in distinguishing the laws of Distribution from those of Production does he break away from the earlier idea, removing, as the distinction does, a part of economics from the dominance of physical causes.

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[1] See Patten, *Development of English Thought.*

[2] See Leroux, *Lettres d'Aug. Comte à J. S. Mill.*

Summary Appraisal. — If one were merely listing those who have added new material to the body of economic theory, John Stuart Mill's name would hardly be mentioned. He did not succeed even in presenting a logically consistent restatement of the economic doctrines of Smith, Ricardo, Malthus, and Senior. Nevertheless, one cannot understand the history of economic thought without understanding Mill. In the first place, his writings had great influence for over a generation. He was a great expositor, and his *Principles* was long accepted in the English-speaking world as the leading statement of economic doctrines. But more than this, Mill was a leader in the development of the philosophical basis of economics. It should never be forgotten that his real contributions were the following:

(1) He led in the application of the idea of utility to institutions and policies, thus helping to free the Classical economics from its deadly assumptions of a "law of nature" and "natural rights."

(2) He led in recognizing the importance of an understanding of the relation between individuals and society, and in developing the principles underlying a social point of view and the relation of government to industry.

It should be added that he at least appended to the Ricardian economics, statements that its "laws" are limited by customs and "institutions"; and he warned that they are "provisional" and "not final." Mill contributed to an understanding that positive economic laws are subject to time and place, and must be based upon consciously adopted and definite presumptions concerning man and his environment.

Mill's great limitations were: (1) his fixed acceptance of the economic doctrines learned in his youth, and (2) his lack of the technique required in economic science. Outstanding, are his failure to develop the marginal analysis, either in production or consumption, and his shortcoming in appreciation of utility as an economic concept. (As a company official, a "man of letters," and a social reformer, how could he have been a highly specialized economic theorist!)

Strangely enough, moreover, Mill's great weakness lies in his inconsistency and confusion in mixing social and individual points of view. He seems to be vividly aware of society and a social well-being. But he proceeds to take the individual entrepreneur's point of view in treating economic value as determined by "expense," and he attaches a determinative significance to "alternative uses" and "scarcities" which are themselves determined by market values.

Closely connected with this weakness, is his failure, after distinguishing the laws of distribution from those of production, to correlate the two through value. He did not really *understand* — and perhaps did not believe — that production and distribution are interrelated through the processes of valuation, and that each limits the other.

But how many economists today are free from all the errors to be found in Mill's thought?

John Stuart Mill deserves recognition as a great expositor of social and economic doctrines. His claim to greatness in economics, however, lies not in his doctrinal contribution, but in his thought concerning the postulates and assumptions of economics, and its relation to the social sciences in general and to social policy.

V. OPPONENTS AND LEADING CRITICS
(*Resumed*)

1. THE PHILOSOPHICAL AND ETHICAL SYSTEM (*Resumed*)

a. Socialistic Critics (Resumed)

CHAPTER XXIV

THE RISE OF "SCIENTIFIC" SOCIALISM[1]

The earlier French and English Socialism, down to 1848, was largely Utopian and idealistic. Down to 1848, too, it was dominated by a bourgeois or middle-class spirit, and was not of and for the wage-earning class; though, with Louis Blanc and Proudhon, the transition to a proletarian spirit, opposing labor to capital, is manifest. Moreover, none of the writers who have been discussed can be called "State Socialists," that is, Socialists who accept the government as the agency for carrying out their programs. True, Louis Blanc and Proudhon relied to some extent upon the state; but the former was half an associationist, or group Socialist, and the latter was an anarchist in his way.

We are now to pass to thought in Germany and the purely proletarian Socialism of the second half of the nineteenth century; a Socialism which, though it draws largely from its French and English predecessors, ridicules the Utopian ideals of the earlier group, and prides itself upon its "scientific" realism. And first, it is logical to take up the thought of a group of thinkers commonly known as "State Socialists," chief of whom are Rodbertus and Lassalle.

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[1] See the references under Chap. XXI; and *Handwörterbuch d. Staatswissenschaft*, articles on "Socialism," "Rodbertus," and "Marx"; Laidler, *A History of Socialist Thought;* Flint, *Socialism;* Skelton, *An Analysis of Socialism;* Böhm-Bawerk, *Capital and Interest*, Bk. VI, Chaps. II and III (English translation by Smart, pp. 328–392), also *Karl Marx and the Close of His System* (English translation, London, 1898); Gonner, *The Social Philosophy of Rodbertus;* Masaryk, *Die philosophischen und soziologischen Grundlagen des Marxismus;* Beer, *The Life and Teaching of Karl Marx;* Salter, *Karl Marx and Modern Socialism;* Nicholson, *The Revival of Marxism;* Lindsay, *Karl Marx's Capital;* Davis, J., *Contemporary Social Movements.*

As just intimated, they accept the state as the agency for applying their theories, and seek to enlarge its economic functions accordingly. Properly speaking, a "State Socialist," then, is one who advocates a radical scheme of social reform to be carried out by government. They are, therefore, generally nationalists, and stand opposed to the cosmopolitan, international, or universal Socialism of Marx, on the one hand, and to the associationist or group Socialism of Owen and Fourier, and Louis Blanc, on the other.

1. State Socialism: Rodbertus and Lassalle. — a. *Rodbertus.* — Karl Rodbertus (1805–1875) has probably exerted more direct influence upon economic thought than any other Socialistic writer, unless it be Marx. This is especially true in Germany, where such men as Wagner admit his influence; but it may be seen even in the thought of American economists. His chief economic writings are: *Zur Erkenntniss unserer staatswissenschaftlichen Zustände* (Our Economic Condition), 1842, which contains his leading views; *Sociale Briefe an von Kirchman* (Social Letters), 1850–1851; *Zur Beleuchtung der sociale Frage* (Light upon the Social Question), 1875; and *Der normal Arbeitstag* (The Normal Labor Day), 1871. The last essay contains his plans for immediate reform.

Rodbertus' economic thought may be analyzed as proceeding from two main ideas: a labor theory of productivity, and a belief in a decreasing wage share. The second idea is connected with the so-called iron law of wages, that is, a subsistence theory. Putting these two main ideas together, he emphasizes the problem of distributive justice, and evolves a notable theory of crises.

In the first place, then, he believed that labor produces all economic goods, — either directly, or indirectly through tools and machinery.[1] Only those goods are economic which are produced by labor, others being "natural." More than that, manual labor is meant. Intellectual labor is very important; but it is not costly, and is to be regarded as a free gift of nature, like land. It will be observed that this does not necessarily mean a labor theory of value: Rodbertus says labor creates *products;* he does not say values. Economic goods, however, all have value, and he thought that labor was the best measure of value. Simply, he does not say that labor actually does *determine* value. But he believed that labor *ought* to be the basis of value, and that it would be so in a properly organized society, — one in which production would correspond to social needs.

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[1] See *Zur Erkenntniss*, pp. 7 ff.; *Schriften*, II, pp. 105 f.

The "law" of a decreasing wage share (*Gesetz der fallenden Lohnquote*) was formulated by Rodbertus as early as 1837.[1] By it he meant that the proportion of the national income received by laborers continually decreases. The total amount paid in wages may increase, but rent and interest take an increasing percentage of the aggregate income. In formulating this law, Rodbertus was probably influenced by Sismondi, and it appears to be a simple deduction from the subsistence theory of wages of the Classical economists, narrowly, and erroneously, interpreted. The argument is that if production is continually increasing, while labor as a commodity merely gets enough to cover cost, its proportional share decreases.

The national income, consisting of goods that are of direct importance to life, is divided by Rodbertus into two parts or shares: wages and rent. Rent, in its turn, falls into two parts: land rent and capital rent. The existence of rent is said to be due to two facts: (1) the economic fact that there is a surplus produced by laborers over their subsistence, and (2) the juristic fact that private property in land and capital enables the owners to exploit labor, and retain that surplus. In these ideas, again, Rodbertus is clearly following the thought of Sismondi, Proudhon, and the Saint-Simonians.

From the two main ideas thus briefly sketched, Rodbertus concluded that the great mass of mankind is unjustly shut out from a participation in the income which it creates, a condition that is inimical to culture. Indeed, his great service is to have brought out sharply the question of distributive justice. With more economic learning and statistical data than his predecessors, coupled with a forceful presentation of the issue, he drove home the fact that there is a problem in the poverty of the masses, which partly, at least, concerns economics as a science.

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[1] *Die Forderungen der arbeitenden Klassen* (1837); found in *Zur Beleuchtung.*

Rodbertus' famous theory of crises is also derived from his theory of a decreasing wage share. Very briefly stated, it is that, as the great mass of wage earners have a diminished purchasing power, consumption fails to keep pace with production. A contraction of production ensues, with unemployment and a further decrease in purchasing power, leading to an intensification of the crisis. The similarity of this idea to Sismondi's theory of overproduction will be observed, and it is open to the same criticism. Moreover, if we are to assume that an increase in labor's share, or wages, would remedy the matter, it appears that the validity of the theory depends upon an assumption that capitalists in general are receiving more than a return necessary to secure the activity of capital; otherwise wages could only be increased at the expense of capital and a consequent restriction of production. Thus the theory rests upon the exploitation idea.

Poverty and crises are to be done away with, and distributive justice to be attained, by an ultimate socialization of property. This, however, should be an evolutionary process. History, Rodbertus thinks, shows three great stages. The earliest is the period of heathen antiquity, in which human beings are owned, and labor is thus exploited by the rent receivers. In the second, or Christian-Germanic stage, land and capital are private property for the use of which the owners demand an unearned rent. This is the existing condition. In the future, a Christian-Social stage is to come, in which land and capital will be nationalized, and private property be allowed only according to service or desert. This stage might be expected in five centuries, perhaps.

Although his "stages" do not exactly correspond to any historical periods, and cannot be accepted in a rigid sense, Rodbertus deserves credit for careful historical study and for a broad conception of the relativity of social institutions. He was no mere radical revolutionary.

As to immediate and practical remedies, Rodbertus chiefly proposed various regulations of the labor contract, with the idea of increasing labor's share in the national income. He advocated the legal establishment of a "normal" working day. Moreover, the determination of a normal amount of work to be performed by an average worker in a given time, was favored by him. This average production would serve as a standard of value, according to which each laborer would be credited. Prices, too, would be fixed, and be measured in a labor currency in a manner quite similar to Owen's scheme. By such devices, the transition to his third stage would be hastened.

Of course, Rodbertus attacks Smith's system with its competitive basis. His most fundamental critical idea lies in the opposition of a social demand to the "effective demand" of the economists; or, just to put it in another way, he emphasizes utility rather than exchange value, — an idea in developing which, Sismondi preceded him. Rodbertus, however, fits it into the garb of Socialism. The "effective demand," he says, is a property demand. Property-owners determine production, directing it so as to secure the largest net profits rather than the largest amount of essentials. Luxuries are produced, while the most intense wants go unsatisfied.

Among other points, Rodbertus criticizes the Classicists on historical grounds for assuming the existence of an original state in which men were equal in property and political rights. History, he thought, always shows inequality, and exploitation of the weak by the strong. And in a similar vein, a distinction is drawn between capital as a logical functional concept and capital as an historical fact.

Naturally the wages-fund theory is rejected, as, according to his assumptions, Rodbertus could not believe that wages are paid out of capital.

Passing over his criticism of Bastiat's interest theory, this résumé of his chief economic criticisms may be concluded with a note concerning his theory of rent. Ricardo's doctrine, he thinks, is overturned by his fancied proof that rent would exist even if all land were equally productive. Differences in productivity merely explain differences in rent, he argues, not the origin of rent.[1]

His own theory, which is probably suggested by certain passages in the *Wealth of Nations*,[2] is a notable illustration of the inconsistencies which so abound in the strictly economic thought of Socialistic writers. Starting from the idea that the price of all products corresponds naturally to their labor cost, and that the prices of manufactures and raw materials are thus on a similar basis, even though land ownership is a legal monopoly; he concludes that landowners get a larger return than capitalists, in that the latter must pay for raw materials, while land is a free gift of nature. Landowners, as such, having no expenses for raw material, secure a larger net return, which is land rent. Or to put it another way, land itself is the landowner's raw material, and he can normally demand enough for its use to cover the customary gain of the capital engaged in producing raw materials required in other industries. The whole idea reminds one of the Physiocrats' surplus and Smith's notion that in agriculture "nature" labors with man in a peculiar way. It involves a failure to see that in economic society land values are themselves capitalized.

But, one asks, what then of the differences among different manufacturing industries in this regard? Does the manufacturer of rails or girders secure a lower net return than the producer of iron and steel, just as the latter is assumed to secure less than the owner of the iron mine or land? Not if the labor-cost theory is to be maintained, for this reasoning makes land ownership an element in value! Yet this conclusion would follow from his rent theory. His rent theory is inconsistent with his theory of labor cost; and leads to conclusions that are contradicted by the facts of equalized "profits" in competitive industry.[1]

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[1] See *Beleuchtung*, pp. 170 f.

[2] Bk. I, Chap. VI, paragraphs 10 and 11. "In the price of flour or meal, we must add to the price of the corn, the profits of the miller, and the wages of his servants," etc. "In the price of linen we must add the wages of the flax dresser." "The capital which employes the weavers . . . must be greater than that which employs the spinners. . . ."

b. *Lassalle.* — Ferdinand Lassalle (1825–1864) was the Louis Blanc of German Socialism. His chief work was that of the agitator and propagandist. He founded the Social Democratic Party. His thought needs no long consideration, for in its main outlines it was that of Louis Blanc, Rodbertus, and Marx.[2] Lassalle it was who made the phrase "iron law of wages" his own. Accepting the subsistence theory of wages, he taught that under the capitalistic system the position of labor is hopeless. Therefore capitalism must be abolished, and coöperative association be put in its place. "Productive association with state credit" was his scheme.[3] And the state was to guard the funds of the associations and maintain suitable rules.

The most notable points in Lassalle's writing are the brilliant way in which he seeks to drive home the significance of capitalism, and his theory of *Konjunctur.*

"Capital," he takes broadly to be the name for a group of political, economic, and juristic conditions which are not absolute and permanent, but the result of an historical development. An examination of the existing economic order shows that its essential features are division of labor, production for a world market, competition, and the ownership of the instruments of production by the capitalist class, which exploits wage earners by paying them according to the iron law of wages, pocketing the surplus. Capital, "the dead instrument of labor," has become the active agent, degrading the living laborer.[4]

In opposing individualism Lassalle was led to deny that the individual controls his own destiny. There is a large element of chance, or conjuncture, he said, that dominates individual endeavor and makes control by society necessary. Wars, crises, etc., are of social origin, and largely beyond the scope of individual action. It is therefore folly to rely upon individual initiative and self-interest, as do the Classical economists.

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[1] Cf. Lexis, "Zur Kritik der Rodbertischen Theorien," *Jahrb. f. Nat. Ök.*, N. F., IX, 469· Oppenheimer, *Ricardo's Grundrententheorie*, pp. 38 f.

[2] *Das System der erworbenen Rechte*, 1861.
Workingmen's Programme, 1862.
Open Letter, 1863.
Bastiat-Schulze, 1864.

[3] *Open Letter*, *passim.*

[4] *Bastiat-Schulze*, pp. 181 f.

2. International Revolutionary Socialism: Karl Marx and Friedrich Engels. — For a generation, Karl Marx was the undisputed leader in Socialistic thought, and his chief work, *Das Kapital* (Capital), 1867, came to be called the Bible of the "scientific" Socialists.[1] If it is now true that its prestige has been somewhat shaken by "higher criticism," at the beginning of the twentieth century it was still the leading source from which the great mass of intelligent Socialists drew.

Karl Marx was born in 1818 at Trèves, Rhenish Prussia. He studied philosophy and history at Bonn, and became intimately acquainted with Hegel's thought. He was also influenced by Lorenz von Stein in regarding the social movement as an evolution.[2] Marx became a radical editor, was driven from Germany to France and thence to Belgium, finally taking up his residence in London, where he lived until his death in 1883. The spirit of the generation in which Marx lived was largely his, and it has been well characterized as "the irreverent and revolutionary spirit of what was once known as Young Germany; the spirit of a race of disillusioned men, without belief in God or unsensuous good; a hypercritical, cynical, and often scurrilous spirit. In passing into its latest or Germanic stage, Socialism gained intellectually, but lost morally." [3]

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[1] Other works are: *Einleitung zur Kritik des Hegelschen Rechtsphilosophie* (1843) (Introduction to a Critique of Hegel's Philosophy of Rights), containing the germs of his materialistic conception of history; *Misère de la philosophie* (1847) (The Poverty of Philosophy, a criticism of Proudhon); *Discours sur la question du libre exchange* (1848) (Discourse upon the Question of Free Exchange); *Zur Kritik der Politischen Oekonomie* (1859) (A Contribution to the Critique of Political Economy). Only the first volume of *Capital* appeared in 1867. The two other volumes were brought out in 1885 and 1894, after Marx's death (1885), by his collaborator, Engels. Engels' chief work was *Herrn Eugen Dühring's Umwälzung der Wissenschaft*, 2d ed., 1886. The Communistic Manifesto of 1848 was the joint work of Marx and Engels.

[2] See below, p. 537.

[3] Flint, *Socialism* (1895), pp. 136–137.

With Marx, Socialism took on a purely materialistic garb, and became international or cosmopolitan in its scope as contrasted with the national industrialism or associationism or State Socialism of his various predecessors. Marxianism is the classicism of Socialistic thought, — abstract, deductive, cosmopolitan. Rodbertus was an idealist. So were the earlier French writers who clung to the institution and believed in the innate goodness of man. But Marx was in fierce revolt against institutions, including the existing states, and was far from believing that good predominates in mankind. Accordingly he put Hegel's dialectic upon a materialistic basis, and made social evolution a matter of material and economic forces. To Marx "the ideal is nothing else than the material world reflected by the human mind." [1]

Indeed, one of the things ordinarily associated with the name of Marx is his materialistic interpretation of history, and especially his analysis of the existing capitalistic stage. These ideas, together with that of class struggle, are the essential basis of revolutionary international Socialism.

Marx wrote: "The mode of production in material life determines the general character of the social, political and spiritual processes of life." He holds that all social institutions are determined and conditioned by economic circumstances, and especially the conditions of production. These economic circumstances change with developments in technique, inventions, discoveries, and the like, while institutions become fixed and thus lag behind. The latter thus get out of harmony with industrial technique, and have to be shaken off by revolution.

He describes the transition from the domestic system of production to the factory system, and proceeds to argue that, under the factory system (with private property), the advantages of large-scale production will have the following consequences: small-scale employers will be eliminated, and capital and land will become increasingly concentrated in the hands of a few. The middle class will become merged into the labor class, and the masses of the people will be employed by a small capitalist class. The latter cannot consume the increased production, but reinvest their gains in production goods, thus further increasing the output. The labor class, being exploited and weighed down by an "industrial reserve army" of unemployed, cannot provide an adequate market, because of lack of purchasing power.

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[1] *Capital*, preface to second edition.

Therefore, Marx concludes, crises will become increasingly severe. Eventually the labor class will rise, cast off their chains, and seize control of the capitalist state, — the expropriators will be expropriated. Finally, Socialism will be established by and for the proletariat.

Several others of the Socialists had analyzed the development of society into stages, with more or less elaboration of their material characteristics. It remained for Marx, however, to develop the idea that all social changes have their ultimate causes in the modes of production and exchange, or that economic factors dominate all history and determine social organization, classes, and class interests.[1] In the present stage of history, capital — which he, like Rodbertus, regards as an "historic concept" — stands opposed to labor, the latter being exploited. Here Marx presents an acute analysis of industrial conditions, which has its value, even though largely vitiated by a warped point of view.

It is essential to understand his notion of capital, for it is not the ordinary one.[2] To Marx, circulation of commodities is the starting point of capital, and he dates the "modern" history of capital from the sixteenth century, when a world commerce arose. "As a matter of history, capital, as opposed to landed property, invariably takes the form of money; . . . the first form of appearance of capital is money." Then by purchasing labor power for less than it is worth and retaining the surplus, money is converted into capital. "By turning his money into commodities that serve as the material elements of a new product, and as factors in the labour-process, by incorporating living labour with their dead substance, the capitalist at the same time converts value, i.e. past, materialized and dead labour into capital, into value big with value, a live monster that is fruitful and multiplies," — a "vampire" that sucks the blood of labor. Capital is wealth used to exploit labor.

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[1] Friedrich Engels, Marx's collaborator, urges that Marx did not take such an extreme view; see his *Socialistischer Akademiker* (1895). It is not unlikely that to say that Marx makes the economic factor the *sole* factor in historical development is going too far.

[2] See *Capital*, Vol. I, Part II, Chap. IV, and Part III, Chap. VII.

Thus Marx's idea of capital as an "historic concept" is part and parcel of the idea of a surplus value that labor creates and capital appropriates. The idea of surplus value is his most famous contribution. It demands attention next.

In the first place, it will be remembered that most of the earlier Socialists had the same general idea, and that the Englishman, Thompson, had a very definite one. Such originality, then, as Marx has, must lie in his formulation and attempt at proof.

This begins with his theory of value. Marx starts with an abstraction. The "use-value" of commodities is distinguished from their "exchange value," or value, for short. We are then told that "if we abstract their use-value," there remains only the quality of value in exchange. Since Marx thinks that labor produces all value — capital being nothing but stolen labor — it follows that this abstract value quality exists "only because human labor in the abstract" has been embodied in goods. Value is "a mere congelation of homogeneous human labour" — "crystals" of a "social substance."[1] All this concerns the *qualitative* aspect of value, a phase which Marx thinks the economists had unduly neglected.

The value of a commodity being thus "abstracted" from all relation to its form or use, it remains to discuss its determination in exchange, or the quantitative aspect. *Assuming the existing social order,* Marx concludes that the quantity of value in a commodity is determined by the socially necessary labor-time, — the time spent by the average laborer under existing social conditions. If it requires x labor hours to make the linen and $2x$ labor hours to make a coat, the coat has a value twice as great as that of the linen.

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[1] Vol. I, Chap. I.

Marx criticizes economists for not analyzing separately the qualitative and quantitative aspects of labor as entering value, and for not reducing labor to abstract social labor.

It is obvious that certain difficulties are inherent in the attempt to reduce labor to an abstract fund, owing to the differing character and intensity of labor, — to say nothing of the differing utilities of products, which Marx "abstracts," although Aristotle had made utility the very standard of value.[1] These difficulties Marx in part recognizes. He attempts to get around them (1) by conceiving of all labor power and all values as funded into homogeneous social aggregates, divisible into equal units; (2) by limiting his conclusion to "normal conditions of production" and "the average degree of skill and intensity prevalent at the time."

Having thus defined value and based it upon labor time, Marx proceeds to argue that capitalists, in hiring labor, secure a surplus of value. In itself an old idea, Marx elaborates its argument somewhat. Assuming that the exchange value of a day's labor power is a certain sum, determined by the fact that the means of subsistence required for the day cost half a day's labor, he argues that this does not prevent his working a whole day, nor determine the value of the laborer's daily product. The capitalist, in short, buys of the laborer the "use-value" of a day's labor power for its exchange value or cost, and the difference is his surplus, or "profits." [2]

Criticism of the main points in Marx's economic theories must be adverse. To begin with, his underlying philosophy of history is indisputably one-sided. Too many things occur for reasons not entirely economic, or even not economic at all. The economic interpretation of history must be incomplete, but if such an interpretation is also materialistic, it is doubly limited. Marx was grossly materialistic in his economic thought, and herein lay his fundamental error. There is an element of truth in his position that economic forces are very important factors in shaping history. This it was well to emphasize. But others had done this, notably Comte; and Marx's countryman, Lorenz von Stein, may have given him some of his ideas.

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[1] See above, p. 65.

[2] See *Capital*, pp. 174–176.

His chief historical conclusion immediately concerns capital. One must feel that here, as elsewhere, his desire to prove surplus value and exploitation, rather than historical study, influenced him. To say that capital has not always existed where men use tools to aid in production is only possible when a peculiar and question-begging definition of capital is adopted.

Moreover, it is contrary to his own method of historical interpretation to overlook the social services and the economic function of the capitalist class. Its initiative was largely instrumental in overthrowing feudalism; its enterprise and management are of value today.

But the element in Marx's thought which gave his "scientific socialism" its peculiar form, and shaped the policies which he advocated, was his theory of value and the related doctrine of surplus value. There was no theory of value in the *Communist Manifesto,* — but neither was there a definite content given to the general idea of Socialism. Marxian Socialists sought to remedy certain evils in a certain way. These evils center in exploitation; exploitation, in turn, consists in the appropriation of surplus value; and the concept of surplus value depends upon the theory of value. Other Socialists, as Proudhon, had other explanations. While Marx propounded his theory of value as a scientific explanation of how values are determined, his theory shaped his practical program: Marxian economics is vitally connected with Marxian Socialism. The economist's criticism of the Marxian theory of value, therefore, bears in an important way upon the essential logic of Marxian Socialism.

(1) That theory of value is unsound, in the first place, in its

vicious abstraction of utility.[1] This unfits it for a general explanation of the source of value. Regardless of form or use, things would be valued in Marx's scheme according to abstract labor-time. As a result of such a theory the gifts of nature could have no value; and so with anything that has not cost labor. Marx here tries to meet the difficulty by drawing an inconsistent and illogical distinction between value and price, stating that such things may have a price but not a value! On the other hand, there is this question: Are all things that have involved labor valuable? Marx admits that such things may not have value. He says that they must be socially useful to acquire exchange value. But where such is the case he seems arbitrarily to regard the *labor* involved as being useless, overlooking the fact that it is primarily the utility of the commodity that is decisive.

Marx again glides over the utility difficulty by assuming a "social process" by which labor is directed and equated, a process which, when it is analyzed, is seen to operate through utility. One cannot get away from the question, Why do men work? Why do they devote labor-time to cotton rather than to linen?

(2) But in the second place, even assuming that cost alone can explain exchange value, it is not true that costs can all be reduced to labor. The claims of capital must be met even in a collective state, they being based primarily on the economics of the situation. Marx did not go back far enough here. His assumption of the sufficiency of his "historic concept" of capital was made to serve. If labor alone made the spindle, the machinery that, in turn, helped make it, and finally the metal and the mine appliances, how were these last made? The element of saving and waiting is there and it must be a cost, whether private ownership exists or not. Marx assumes that his surplus is produced by labor. This, however, cannot be proved; and

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[1] In reality Marx scarcely deals with utility at all, his "use-value" appearing to be generally thought of as the material of the good and having merely the negative quality of providing a body for the abstract labor-time units.

unless it is, it does not necessarily indicate any exploitation of labor.

(3) The reasoning concerning abstract labor-power units breaks down before insuperable differences in the quality of labor.[1] We are virtually told that as entering value determination the labor of the artist may be equated with that of the hod-carrier by merely taking one day of the former's exertion to equal twenty or thirty of the latter's. As well think of an ounce of canvas from the masterpiece as equal to so many pounds of mortar! Labor is exerted on different planes. It can be reduced to a common basis and funded only by eliminating a large part of the laborers, or by performing the impossible feat of adding art or skill to brute force to get "congelations" and "crystals."

(4) Finally, the reasoning of Marx concerning "surplus value" fell before the same difficulty which caused Ricardo to qualify his labor-cost theory of value, namely the time element in capital. Marx assumed that the rate of surplus value always equals the rate of profits, an assumption which can be true only when the composition of the capital used in different industries is the same as to the proportion of fixed and circulating elements. He admitted that only "variable capital" yields "surplus value," for it alone employs labor. Therefore, while the absolute amount of "surplus value" increases with the amount of variable (circulating) capital, the *rate* of profit depends upon the total capital employed, and must vary with the proportion of circulating to fixed capital. Thus Marx's logical chain is broken by the fact that profits and surplus value depend in part upon capital. If a manufacturer employs only a few laborers, but gets a large income by using much plant and equipment ("constant capital"), is he exploiting "living labor"? Or is a manufacturer who employs much "living labor" necessarily one who makes a proportionally large profit? In fact, the rate of profits (interest) tends to be equalized among different industries.

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[1] Cf. Adam Smith's idea of an average labor cost. Above, pp. 221 f.

In the face of these difficulties, Marx was compelled to resort to an explanation which was a confession of failure: His theory of value, he wrote in the third volume of *Capital,* was intended to explain only *total* value, and proves only that the value of all goods combined must equal total labor-time. Prices of particular goods, he admits, rise and fall not as a result of labor-time value changes, but from the effect of the credit system, competition, and so forth! In a word, like Ricardo, he was forced to admit that the time element (interest rate) is after all a factor in the determination of value.

Karl Marx cannot stand as an original thinker. Both in economics and philosophy he took from others. From Smith and Ricardo he took his ideas of value and capital. From the same source, supplemented by Lorenz von Stein and others, came his doctrine of class struggle. His analysis of economic processes came largely from Thompson and Rodbertus. What one of his theories cannot be found definitely stated in the publications of his predecessors?

More than that, none of his theories has stood the test of logical examination; his philosophy has been found unreal and one-sided; his prophecies have not been verified.

Yet Marx lives, and no one has so influenced the development of Socialism as he. He found Socialists disorganized and ineffective; he gave them a purpose and a philosophy — a spirit — which have made their movement a great force. How can this be? Perhaps it is not entirely explicable, but the following points are worthy of note:

(1) Marx came at the right time — a time of organized labor in England, the Revolution of 1848 in France, and intolerable conditions in Germany. The factory system had become fully developed.

(2) He provided a militant negative or revolutionary body of doctrine, which was in accord with the sentiment of great masses of suffering or discontented men. The immediate need was to pull down or destroy.

(3) His thought was cloaked in "scientific" terms. This both

heartened his followers and challenged the attention of their critics. As economic "scientists," the Socialists gained a new standing! It has taken many years to refute the errors, and the tradition remains.[1]

(4) He gave a group of phrases and slogans which was effective. As is sometimes the case, a terminology plays an important part — the same phenomenon appears in the case of Veblen and "Institutionalism."

(5) Last, but not least, Marxian Socialism, despite its materialistic setting, and its appeal to revolution, is built upon unreal assumptions, and in the last analysis holds out the hope of an ideal state. It provides an idealized villain in the shape of the vampire, "Capital." Then, when "the knell of capitalist private property sounds," and "the expropriators are expropriated," will not all be well? Instead of synthesis of the material and the ideal, Marx provides a practically effective mixture of material means to an ideal, if vague, goal. Like the founder of some religious sect, he provides something to do in the way of proselyting and "saving," and then — some sort of heaven.

The foregoing is but the barest sketch of the leading ideas in Marx's economic doctrines. It is, however, sufficient for a general history of economic thought as distinguished from Socialistic thought. Marx was a learned and ingenious writer, and possessed of a good deal of dialectical skill. But he was filled with a preconceived idea which led him into question-begging assumptions and one-sided analyses. He took certain ideas from Smith and Ricardo, for whom, of all economists, he had the most respect, and, robbing them of the qualifications made by those writers, applied them in an even more abstract way than they had done.

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[1] A sympathetic statement of his merits is the following: —

"In the combination of learning, philosophic acumen, and literary power, he is second to no economic thinker of the nineteenth century. He seems to have been master of the whole range of economic literature, and wielded it with a logical skill not less masterly. But his great strength lay in his knowledge of the technical and economic development of modern industry, and in his marvelous insight into the tendencies in social evolution determined by the technical and economic factors. Whether his theories in this department are right or wrong, they have suggested questions that will demand the attention of economic thinkers for a long time to come. It is in this department, and not in his theory of surplus value, that Marx's significance as a scientific economist is to be found." (Kirkup, *History of Socialism*, pp. 164–165.)

3. Revisionists or Opportunists. — Since the active days of Marx and Engels, other groups of Socialists have arisen, which may be called opportunist or revisionist. Such Socialists are not revolutionary, but "evolutionary." They are more inclined to await developments. Toward the doctrines of Marx, they are more or less critical. Thus, in Germany, Bernstein criticizes the theory of surplus value, and denies that the condition of the laborers is going from bad to worse, or that capitalism[1] will necessarily collapse. And he is far less materialistic than Marx. Much the same may be said of Jaurès in France. In England, Sidney Webb is one of the leading "Fabian" Socialists. The tendency is to reject both the materialistic interpretation of history and the theory of surplus value, while accepting the doctrines of class struggle, internationalism, and the socialization of the instruments of production.

Brief Summary of the Main Developments in Socialism since Marx.[2] — One notes first that those who profess to be *Marxian Socialists* are still active, as such names as Kautsky in Germany, Hyndman in England, and Hillquit in the United States, attest.

The First International, formed in 1864, with the coöperation of Marx, was a militant organization. By the seventies, however, it became apparent that the contradictions in Marx's doctrines, the growing criticism of his philosophy and economic theory, and the failure of his prophecies concerning the growing misery of laborers and the downfall of capitalism, were weakening the movement.

The Second International was formed in 1889. It was less militant, and embraced all sorts of Socialists. While maintaining the bulk of Marxian doctrines (with more or less exegesis), the Neo-Marxians are less revolutionary, make more concessions to mere "reform," and are more given to political action.

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[1] *Die Voraussetzungen des Sozialismus* (American translation New York, 1909).

[2] See also the note appended to this chapter.

The *Revisionists* became prominent at about this time, notably in Germany where the Social Democratic Party represents their general position. Their thought is related to Marxianism, but they are evolutionary, and rely upon universal suffrage and the processes of democracy to attain the socialization of production. E. Bernstein is a typical Revisionist.

The Fabian Society was formed in England in 1884, its members being dubbed *Fabians,* signifying a cautious or even hesitant spirit. They include such persons as G. B. Shaw, Annie Besant, H. G. Wells, the Webbs, G. Wallas, and J. R. MacDonald. The Fabians reject Marx, and draw upon John Stuart Mill and Henry George. They stand for gradual reform. They are essentially idealists. Their chief reliance has been upon education as a means, and their most generally accepted immediate aim the government appropriation of "unearned income," both from land and from capital.

Meanwhile, *Syndicalism* has developed. This movement originated about 1875 in France, becoming fully developed in the nineties during the struggle of different Socialist groups to control French labor unions (*syndicats*). The best-known exponents are Georges Sorel (1847–1922) and Ferdinand Pellontier (1856–1901). While the Syndicalists are extremely radical, they are non-Marxian, their beliefs being more influenced by Proudhon's anarchism. They thus have a different idea of the part to be played by the state. While accepting the doctrine of class struggle, they seek as their goal the abolition of the political state, and the substitution of a condition of self-government by the workers, who are to be organized in non-political "industrial" unions. The general strike is their great weapon.

Syndicalism has exercised a considerable influence in the United States, through the Socialist Labor Party (formed in 1877) and the I.W.W. (Industrial Workers of the World, 1905).

Finally, the *Guild Socialists* are to be mentioned as representing the latest variety of Socialist thought. This movement, which became effective shortly before the World War, has been chiefly English, and is represented by Tawney, Cole, and S. G. Hobson. It seeks to harmonize Socialism and Syndicalism, advocating self-government by producers, but proposing a system of national gilds among producers and a national organization of consumers.

Philosophy and Socialism. — Being one of the most sharply defined lines of development in economic thought, Socialism furnishes an interesting field for testing the relationship between metaphysics and economics, the general outlines of which have been sketched on pages 8 to 20.

It may be stated that not only was Socialism in its beginning idealistic, but that Socialism must be idealistic if it is to be logically consistent, and to build up a strong system. In the first place, *as radicals*, Socialists believe in the power of human judgment to cope with physical facts: by "taking thought" man can sweep away the sufferings and evils of the existing order. And along with this belief there is generally found the assumption of the perfectibility of man — avowed by Godwin and the early Utopists, and tacitly assumed by all true Socialists today.

Like true radicals they do not count the cost, — which is to say, they do not admit the reality or the importance of opposing views, — and this is manifest in the Socialists' schemes for directing industry according to political opinion of needs, or according to someone's estimate of total utility. In this, they do not count the costs involved in uncertainty and lapse of time, which are the grounds for profits and interest in the existing social order, to say nothing of physical depreciation. This manifests idealism, in the broad sense in which the term is here used.

In the second place, as a special kind of radical, the Socialist stands for *collective action*. In this connection we find the old ear-marks of idealism: the social-organism notion, and confidence in the power of the institution. From the Saint-Simonians who wrote "Humanity is a collective being which develops; that being has grown from generation to generation as an individual grows," to the Fabians who write, "Though the social organism has itself evolved from the union of individual men, the individual is now created by the social organism — and its persistence is accordingly his paramount end," [1] — always the true Socialist thinks as though individuals are or should be fused into a collective unit that can act with singleness of purpose.

Likewise the Socialists not only blame existing institutions, such as private property, for all our social ills; but they believe that by fashioning new institutions we can remedy those ills. Such a belief, of course, indicates considerable optimism, — another indication of idealistic tendencies.

As illustrating both of the last two points, stands the Socialists' teaching that the physical facts of natural scarcity and limited land supply can be negatived by collective ownership or by the abolition of all ownership. Of similar significance, is the fact that the Classical law of diminishing returns is scouted by the typical Socialist.

But, as is apt to be the case with those "systems" of thought that come to be recognized as being on the whole "unsound," we find discordant materialistic elements creeping into the Socialistic Utopia, and remaining there without any synthesis. The earliest Socialist and Communist thinkers were generally pretty aristocratic and recognized the natural differences among men; but the later ones as generally assume, or reason as though they had assumed, the materialistic doctrine that men are naturally equal and that an equalized physical or institutional environment will establish real equality. In thus magnifying the potency of physical facts, however, the Socialists are cutting the ground from under the structure of their idealistic reforms, based upon the power of reason and of human institutions.

Of more immediate economic significance, however, is the Socialists' theory of value. Value as already shown, they have come to base upon cost, and more particularly the cost of labor. Under the influence of Marx they have refused to recognize utility as a determining element in the value problem. Now, cost is the measure of the resistance of nature to man, and it was in terms of cost that the materialistic Classical economist measured value. Surely if the Socialists are to regard human values as dictated by physical facts they must give up their idealistic reforms. Marx's materialistic interpretation of history is his half-conscious attempt to square Socialism with his theory of value and with the science of his day, by making the attainment of his ideals depend upon the operation of physical facts and forces. It is the attempt to make an idealistic body run upon materialistic legs — to proceed in a revolutionary way by evolutionary means.

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[1] Webb, *Fabian Essays*, p. 57.

Socialism would direct industrial activities according to some conception of total utility worked out either through the judgment of leaders having authority or through democratic vote. How can it base economic values upon cost, whether measured in units of pain or of time? To attempt to value goods on one basis and productive activities or industries on another, is foredoomed.

As might be expected, the incompatible materialistic elements are now being rapidly cast out by the revisionists, though not until Socialism has all but lost its integrity as a body of thought.

The Influence of the Socialists. — The influence of Socialistic writers upon economic thought has been a very important one. Especially is this true of Marx and Rodbertus, though it should be remembered that both were heavily indebted to their predecessors. The effect of Socialistic criticisms can be fully appreciated only when its twofold aspect is realized; for, in addition to its direct or primary results, there has been a profound influence which might be called reactional, — a tacit tendency so to modify or state economic doctrines as to take the ground from underneath Socialism.

a. *Direct or Primary Effects.* — (1) In the first place, among the primary effects of Socialistic thought upon economic theory, a point already made with regard to the earlier Socialists should be reiterated. The so-called "scientific Socialists" continued and strengthened the idea that social institutions are of historical growth and relative to environment. This is particularly true of Karl Marx, who added a wealth of illustration from industrial history to strengthen his position. This idea was potent in overthrowing the conceptions of nature philosophy and the "natural."

(2) The Socialists gave greater strength to such tendency as there was among the economists to take the social point of view. As already stated, they emphasized the fact that modern production involves a large degree of coöperation and that the product is to that extent a social one. A similar idea appears in the doctrine of conjuncture. And in their ideas concerning crises and overproduction they kept to the front the concept of social utility, as contrasted with the private, individualistic standpoint, according to which economists considered objective exchange value alone.

(3) Socialistic criticism, moreover, has led to a closer analysis of the economic functions of the state. Whether collectivists, State Socialists, Communists, or anarchists, some more or less radical change in the office of the government was involved; some alteration in the scope of the individual's activity. The discussion of such topics has made possible a more accurate separation of those activities which are most profitably intrusted to the state, from those which are, all things considered, carried on most efficiently by private initiative. The result has been a saner individualism, on the one hand; while at the same time men are no longer alarmed when the government takes over some branch of industry which the principles of politics and economics show will be best administered for the public welfare when in public hands.

(4) Socialism, too, has emphasized the problems of distribution as contrasted with production, and, above all, has kept the question of distributive justice heavy upon our consciences. It must not be thought for a moment that economists as a whole

had overlooked this question. From Adam Smith on, some had dealt sympathetically with it, while others, like Senior, had honestly believed — and perhaps correctly — that their science would make most progress by eliminating such questions, leaving them to ethics and politics. But there is such a thing as undue abstraction and narrowness in this regard. The Socialists, then, with their charges of exploitation, have perhaps done a service to economists by causing them to consider the question, What is a just wage?

On the other hand, it may be that some economists have been led too far afield in discussing such problems; that is, have unduly broadened the field of discussion open to economists as such.

(5) Socialism as a whole has brought the general idea of unearned income into prominence, and particularly "agrarian socialism," in centering attention upon landed property, has emphasized the "unearned increment" of land.

(6) Undoubtedly the function of capital and the nature of interest and profits have been placed in a clearer light on account of Socialistic attacks. It is most obvious that the refutation of arguments that capital is merely congealed labor and that profits are robbery, involved a more careful analysis of the doctrines of Smith and Ricardo than had been given to them prior to the days of Rodbertus and Marx. Even the writings of the earlier Socialists probably had some direct effect in this way.

But somewhat less obvious would be a possible negative influence upon certain theories. It is possible that the downfall of the wages-fund doctrine may have been furthered by Socialistic criticism;[1] while the separation of profits from interest was encouraged, partly because of the Socialist emphasis of the nonproductivity of *capital,* and partly to put interest in a better light. Both of these developments, however, would have come regardless of Socialism.

b. *Secondary or Reactional Effects.* — (1) By way of reaction, Socialism has deeply influenced the tone and emphasis of economic writings. The effects here referred to are far too subtle to be pointed out in detail. One cannot read the works of the Austrian school or of Professor J. B. Clark, however, without finding evidence of what is meant. Today there are few textbooks in economics which do not give some space to a criticism of Socialism, and here and there stress some point in theory as running counter to its doctrines.

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[1] See above, p. 483, and below, pp. 570 ff.

(2) Certain particular theories have probably received their present emphasis, in part, at least, from a desire to refute Socialism. For illustration, the productivity theory of distribution as developed by the Austrians and Professor J. B. Clark may be mentioned. A part of the idea seems to be that if it can be shown that each factor of production gets what it produces, the problem of distributive justice is solved.[1]

And so it is with the *utility* side of value. It is not improbable that the narrow, labor-cost theories of the Socialists helped bring on the reaction to extreme marginal utility theories beginning in the seventies.[2] This would be the logical result of the narrow and extreme way in which Marx carried the doctrines of Smith and Ricardo on value to a *reductio ad absurdum.*

Even before this, as has already been suggested, the theory of abstinence was doubtless stimulated as a result of Socialistic criticism; and in later days, the refinement of this theory as illustrated by the adoption of such concepts as those of "saving" and "waiting" clearly have been stimulated by the attacks which have been made upon the doctrine of abstinence.[3]

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[1] Which idea overlooks the difference between personal and functional distribution.

[2] See below, pp. 581, 626. There had been marginal-utility theories long before, but they had fallen on deaf ears.

[3] E.g., Lassalle's classic bit of irony concerning the abstinence of Baron Rothschild. Cf. Bullock, *Principles of Economics,* 3d ed., p. 140.

APPENDIX TO CHAPTER XXIV

NOTE ON THE EARLY EFFECT OF SOCIALISM UPON ECONOMICS

Socialism, as such, was first effective as a criticism of economics, as such, in France. Saint-Simon, between 1803 and 1823, attacked the optimistic treatment of self-interest as the great motive force in economics and emphasized the functions and duties of individuals in society rather than their rights and privileges. Idleness and misdirection of industry were pointed to as existing evils. His followers raised the social question involved in the separation of laborers from the instruments of production, and indicated the wastes of middlemen Fourier stressed the idea of consumption and the value of association in production. Between 1840 and 1846, Blanc and Proudhon, with a less Utopian spirit, brought out the dark side of competition and maintained the right of all men to subsistence. Proudhon is especially important in this connection, for, though his writing was incoherent, he was most vehement in his direct assaults upon economics, and his criticisms both reacted upon economists and affected later Socialists. He vigorously assailed the institution of private property, especially in land, and challenged the justice of profits. He ridiculed the economists' theory of value, and himself propounded a labor-cost theory. All these early French Socialists held to a rather mechanical historical concept of society.

With the failure of the Revolution of 1848, French Socialism was all but extinguished; but its effects lived after it. In France, economists reacted almost violently, and the extremes of French Liberalism are no doubt in part due to hostility to Socialism. We see this beginning with Bastiat, and down to the present time.

More than this, the torch was handed to German thinkers, and in 1842 appeared Lorenz von Stein's *Der Sozialismus und Kommunismus des heutigen Frankreichs* (*The Socialism and Communism of Contemporary France*). In 1846 Stein made the following statement which is in the nature of a prediction: "The fruitful works of Socialistic literature form an independent whole beside the old political economy. They have not yet been incorporated, but it will be impossible permanently to refuse them their place beside other theories." [1] And it has been in Germany that this prediction has come nearest to fulfillment.

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[1] *Zeitschrift f. ges. Staatswissenschaft*, 1846, p. 242.

First came German "scientific" Socialism with Rodbertus and Marx. Dating perhaps from the *Communist Manifesto* (1848), a theory of social evolution was framed which in its emphasis of the material basis and class struggle has profoundly affected economics.

Down to about 1850, Socialistic thought found little if any hold in Germany, whether in the journals or the economic treatises; but about 1848 the fire was kindled and its glow rapidly colored the thoughts of economists. In that year we find Hildebrand referring to the merits of the Socialists in emphasizing ethical factors in economics. Various conditions, at that time peculiar to German thought, fanned, as it were, this development. More remotely, the Kameralistic background made it easier to incorporate the idea of state participation in industry into economics than would have been the case in England, for example. But above all, a new and truer concept of society was evolving.[1] First came the concept of law and government as products of evolution, and then the clear distinction between the concepts of government and society.

The Classical economists had to a large extent proceeded from a conception of the state or government as constituting the broadest existing social relationship. Within the government, which they conceived of as a quasi-mechanical political organization, the individual atoms moved according to the play of self-interest. They lacked the concept of a more fundamental relationship among men — the concept of "society" as distinct from government; and it followed that certain broader and deeper forces arising out of the social relation were slighted by them. Thus, the effects of low wages *upon society* were little considered. Moreover, even the pale conception of society found in Classical economics was rather abstract and cold. Socialism by stressing the class idea made the class, at least, a live thing. Class-ism (and a class is a part of a living society) became a step toward a broader social point of view. From such a narrow conception of society, German thought had made much progress; and this fact, coupled with the other conditions mentioned, made the appreciation of the Socialists' philosophy much keener than elsewhere. The "discovery" of society did relatively little violence to German economics.

Accordingly, by the sixties the combined forces of Socialism and the general historical and ethical concepts of society, had found clear expression in the thought of leading economists, reaching a climax about 1872 with Wagner's *Rede über die soziale Frage* and the formation of the *Verein für Socialpolitik* (1873).

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[1] See Professor Phillipovich's scholarly article on "Das Eindringen der sozialpolitischen Ideen in die Literatur" in *Die Entwicklung der deutschen Volkswirtschaftslehre im 19ten Jahrhundert*, 2ter Teil.

It is interesting to observe a close parallelism as to time in the development of English thought; though in England neither Socialism nor the Historical School has had anything like the influence which they exerted in Germany. J. S. Mill's *Principles of Political Economy* came in 1848, showing some influence by Saint-Simon and Sismondi. No evidence is found of any influence of Socialism on the discussions of the *Political Economy Club* till between 1850 and 1860. In 1869, we are told, Mill planned a work on Socialism, and only about 1870 did the broader concept of society find clear expression in the writings of Bagehot (*Physics and Politics*, 1872) and Leslie. Of course, one finds discussions of Socialism in earlier English books; but in such books the bearing of Socialism on value and distribution — to say nothing of the concept of society — is generally not recognized. They merely defend private property as a motivizing force in production. Thus M'Culloch in his *Principles* (1825) defended security of property against such writers as Rousseau, Beccaria, and Mably, but went to extreme lengths in making labor the source of wealth without even mentioning them. Malthus, however, showed some effects of familiarity with Socialistic speculations concerning a better organization of society and the perfectibility of human nature.

From Germany the torch was passed to the United States. Socialism came to exert an effect in this country about 1885, as is evidenced by the number of writings on Socialism which date from that time,[1] and by the fact that books on economics begin to show its influence then. Thus A. L. Perry, in his *Elements of Political Economy* (1873) shows no evidence of any direct Socialistic influence. He confuses government with society and advocates *laisser faire* with little qualification.

The reasons for this tardy reaction in America are relatively simple. A strongly individualistic people in a rich new environment with a slight development of capitalism and class consciousness, furnishes shallow soil for Socialistic seed. But with the crisis of 1873 the soil was deepened and enriched. There has come a wave of nationalism with the Civil War and it was strengthened by the growth of corporate business. Capitalism grew fast between the war and 1873, and the labor movement gathered way, finding expression in great strikes and political propaganda about 1876.

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[1] A translation of Proudhon's work on Property was published in Boston in 1876. In 1880 Cook's *Socialism* and Woolsey's *Communism and Socialism* appeared. But in 1884 came Starkweather and Wilson on *Socialism*, and Sumner on *What Social Classes Owe Each Other;* in 1885 Hill on *Principles and Fallacies of Socialism;* and in 1886 Ely's *French and German Socialism*, Osgood's *Scientific Socialism*, Brown's *Studies in Modern Socialism*, Graham's *The Social Problem*, Roles' *The Social Danger*, and Behrends' *Socialism and Christianity*.

Finally, in the early eighties, a considerable number of young German-trained economists furnished a carrier for new concepts of society, — pupils of Conrad, for instance, introducing new ideas on method and state interference. But in 1885, Professor Newcomb, in his *Principles of Political Economy*, devotes some attention to Socialism, and General Walker writing in 1883 shows clear evidence of the effects of the Socialistic leaven. He attacks economists [1] for arguing that there is no danger in wage reductions, and shows that the larger profits may go into luxurious expenditure rather than greater demand for labor, while labor itself may become permanently degraded. He points to the great bodies of brutalized laborers in Europe as evidence. Walker also denies the sufficiency of self-interest to insure wise action, and he specifically recognizes the limitations of a purely economic point of view, criticizing Bastiat for attempting to justify the existing order.

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[1] *Political Economy*, p. 285.

2. THE SCOPE AND METHOD

We now pass to another phase of the criticism of Classical economics.

Political Economy as developed by Adam Smith was not only incomplete in number of theorems established, but was also rather inchoate in form: its *scope* was not clearly defined, and its *method* was not differentiated. It is but natural that, at so early a date and in so early a stage, the new science was, so to speak, neither methodologically self-conscious nor exactly decided concerning its boundaries or subject matter.

For one thing, it naïvely combined within its scope both the arts of economy and government and the science of value. It was a jumble of theory and practical policies, — without being aware of the fact. Smith dealt with the causes of improvement in the productive powers of labor, with the distribution of the produce of labor among the various ranks and conditions of men, and with the effects of the accumulation of capital, — all with the general idea of the enrichment of the people and the sovereign. Evidently this conception of the scope of economics includes a large measure of the art of economy, and its complete development would involve not only a mingling of economics with ethics and politics, but also the inclusion of many technical and psychological data in connection with production and consumption, respectively.

Some economists would have excluded "consumption" from economics; others would have made it the central theme.

Some would have had the economist deal with human "needs," and have made happiness a goal; others would have taken wants of any kind for granted, and have considered only "effectual demand."

Some would have determined the scope of economics according to the interests of society — or nations — as a whole; others would have delimited its field by applying the entrepreneur point of view.

Closely associated with this condition was the wavering treatment of wealth and the problem of value, as regards the objects to which these concepts should apply and their relative importance in economics. Should "wealth" be limited to material goods? Should "productivity" be limited to raw materials or to "vendible commodities"? Should economics be confined to the study of the phenomena of exchange value? Should "value" be limited to its objective manifestations?

The Physiocrats used the term "wealth" to apply to material goods only, and centered economics in exchange value. The English Classicists were more inclined to include "services," but not to treat them as coördinate with material wealth; and, being more concerned with the laborer and with consumption, they came to emphasize the "distribution" of wealth among the members of society. This kept up a steady tendency toward ethical considerations. At the same time, the adoption of the production-distribution-consumption economics tended to maintain the conception of wealth as consisting of material goods and the emphasis of objective values, for the obvious reason that it would be difficult if not impossible to trace the production and consumption of non-material things. *The result was that the Classical economics generally consisted of a body of semi-scientific thought concerning exchange values — of material goods — embedded in a mass of practical doctrines and descriptive statements concerning the well-being of "producers" and "consumers" and the finances of the state.*

The scope of the Classical economics has been criticized by many. To mention but a few, Senior advocated the elimination of the practical and ethical elements. Müller and List urged the inclusion of various intangible social values, or "immaterial capital." Sismondi, too, is well known for his attack upon *chrématistique*, and he desired to make economics the art of increasing national happiness. The absolute and static character of the prevailing economic analysis was much criticized, and notably by the Historical School, to be discussed in following chapters.

Most of these critics, except such as Senior, it will be observed, sought to broaden the scope of the science. It is interesting, therefore, to note a group which argued that the Classical economics was too broad and complex — too loosely knit — to be a real science; and which desired to reduce it to a science of exchanges. This group is briefly discussed in the next chapter, and similar views may be found among the mathematical economists of the subjective school, e.g., Jevons and Walras.

As already indicated (p. 24), the method is related to the scope. Perhaps the relationship is not essential, but the tendency is for one who desires to broaden the scope of the phenomena dealt with by the economist to favor a concrete-inductive method of reasoning. One who narrows the scope usually "abstracts," and seeks a deductive method. When the science is deemed complete and its principles established, the use of induction is apt to fall to a minimum and the use of deduction to prevail.

Accordingly, as the Classical economics grew in power it became more deductive. In the hands of Ricardo and his followers, method became largely abstract and deductive. One does not have to read far in the works of M'Culloch, James Mill, and De Quincey to become convinced of that. And, as has just been seen, John Stuart Mill in his *Political Economy* perpetuated the method. This method is apt to be associated with "absolutism" in thought, as is illustrated by the nature of the assumptions concerning property and competition which were made by the Classical School. These social institutions were valuable adjuncts to the individualistic philosophy which was instrumental in breaking down Medievalism, but when fixedly assumed as "natural," without regard to evolving social conditions, they became the unsound premises for erroneous conclusions.

Following chapters will recount how critics arose against this abstract-deductive method with its attendant absolutism. While attacking the method, they also pointed out the existence of narrowness and fallacies in the conclusions of the Ricardians, and Smith also came in for a share of criticism, though, on the whole, not so large a one.

a. Critics of the Scope of Classical Economics

CHAPTER XXV

THE ADVOCATES OF A NARROW EXCHANGE-VALUE ECONOMICS

Among the earliest criticisms of the Classical School was one directed toward the scope which that school had given to the science of Economics. This criticism attacked the prevailing definition of wealth, and the division of the science into such branches as Production, Distribution, and Consumption; and it was so framed that it might almost be called an attempt at reconstruction. It was unfortunate, however, in that it was based upon such a shallow understanding of the Classical doctrines, and involved such an attenuation of the science, that it gained but a small following.

The criticism referred to, although it was but an offshoot of the Physiocratic system, may be said to have been initiated by Whately, and to have centered in the thought of Bastiat and Macleod. One will find difficulty in discovering any discussion of Macleod in standard works, and Bastiat is commonly known as a shallow optimist who did not succeed in contructing a well-rounded work. Bastiat, however, died (1850) before completing his work; while Macleod was too much concerned with his own ideas to understand those which he criticized. He also lacked the brilliant style of the French writer.

Antecedents of the Exchange-Value Economics. — In order to understand the thought of the writers just mentioned it is necessary to go back to the Physiocrats. It will be remembered that those eighteenth-century economists believed in a harmonious natural order, and were optimistic adherents of the doctrine of *laisser faire.* They regarded value and wealth as mere exchange phenomena, and were not concerned with distribution in the Say-Ricardo sense. Their idea of production, too, differed widely from that later adopted by the English Classical School. While the Physiocratic school came to an end with the French Revolution, its direct influence continued to be felt in France, and has never quite died. Especially to be mentioned is Condillac, who, while a critic of the Physiocrats, had some ideas in common with them; and, what is more to our purpose, appears to have influenced Bastiat and Macleod.

Condillac's ideas concerning value will be referred to in connection with another school of reconstruction. Here it is only necessary to note that he regarded economics as a *science of commerce or exchange,* believed that both parties to an exchange gain, and advocated free trade. Also, he maintained that value is not based upon labor; that in fact cost is sanctioned by value, not value by cost.

Lauderdale also appears to have influenced the advocates of a narrow, exchange-value economics. He clearly showed that there is no intrinsic value, and that no fixed standard of value is possible. Above all, he formulated a sort of law of value, according to which value varies (1) according to the demand and supply which affect the commodity whose value is expressed, and (2) according to the demand and supply which affect the commodity that is adopted as a measure of value. In addition, Lauderdale's distinction between public and private wealth may have suggested the idea of confining economic science rigidly to the latter. The difficulty of harmonizing "public wealth" with "private riches," or the social point of view with the individual point of view, may lead an economist to seek an escape, and he may attempt either to broaden economics into a study of general welfare, or to narrow it to the mathematics of exchanges among individuals, or "business."

Most important as a direct predecessor, however, was Archbishop Richard Whately (1787–1863), who is notable for his argument in favor of making Political Economy a science of

"Catallactics," or exchange.[1] Whately held that in making wealth the subject of the science, economists had introduced confusions arising from the fact that the same things are not always wealth: economics, he said, should be a science not of the things exchanged, but of exchanges. Furthermore, he not only stated that labor is not essential to value, but went so far as to claim that men dive for pearls because they have value. Whately, however, appears to have accepted the main framework of the Classical economics.

The French economist, Dunoyer,[2] in his optimism, his treatment of immaterial wealth, and his doctrine of the ingratuitous service of land, is to be mentioned as a forerunner of Bastiat, — one who handed on Physiocratic influences.

Bastiat. — Bastiat himself has already been discussed as one who on the whole belonged to the Classical School, falling in the French Liberal wing and showing a characteristic optimism. He was a strong believer in a beneficent natural law which, if let alone, would bring the industrial world into harmonious order. To him, men seemed to have an inalienable right to free trade.

The point to be emphasized, however, is that he made value the starting point and center of his economics, and held that value is known only in exchange. "Value consists, then, in the comparative appreciation of reciprocal services, and so one may say that Political Economy is the theory of value." But value, he said, is not necessarily connected with material things; in fact, immaterial wealth exists, and, as indicated in the foregoing quotation, he puts everything in terms of "services." Bastiat would amend the labor-cost theory of value, and substitute therefor the idea of *effort saved* to the purchaser, that is, the "service" rendered.

By assuming that all property represents services rendered by the owner, he would have relieved economic thought of all ethical responsibility.

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[1] *Introductory Lectures on Political Economy* (1832).

[2] See above, pp. 359 f.

In discussing interest, Bastiat says: "Saving implies a service performed, and time allowed for an equivalent service to be rendered in return; or to put it more generally, it means placing an interval of time between the service performed and the service received. . . . The lapse of time which separates the two services exchanged is itself a matter of arrangement and exchange, for it too has value." This is an important early statement of the significance of the time element in the determination of the interest rate.

Macleod. — Henry Dunning Macleod graduated in 1843 from Trinity College, Cambridge, with honors in mathematics. In 1857 he published his *Elements of Political Economy* and in 1896 his *History of Economics*.[1] Though Macleod was neither so brilliant nor so influential as Bastiat, the group of exchange-economics critics may be said to culminate in him. His one great idea is that economics should be made a science of exchanges, and should deal exclusively with exchange value.

He claimed that economics is not only a moral science but also a physical science: "we find that the general laws of exchange, or the principles of commerce, hold good among all nations. . . . The laws of commerce are identically the same today as they were when commerce first sprung into being, and they will remain the same to the end of time. . . . Economics may be raised to the rank of an exact science . . . of the same nature as the physical sciences." He goes directly back to the Physiocrats, hailing them as the true founders of the science, rather than Adam Smith, and he draws support from the Roman jurists, Lauderdale, Whately, and Bastiat.

Professor Marshall, in a note on Ricardo's theory of value, takes up Jevons' criticism, and goes on to say that similar attacks had been made by many, but that "among them may especially be mentioned McLeod, whose writings before 1870 anticipated much both of the form and substance of recent criticisms on the Classical doctrines of value in relation to cost, by Professors Walras and Carl Menger, who were contemporary with Jevons, and Professors v. Böhm-Bawerk and Wieser, who were later."

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[1] Other works: *Theory and Practice of Banking* (5th ed., 1892–1893); *Dictionary of Political Economy*, Vol. I (1862); *Lectures on Credit and Banking* (1882); *Elements of Banking* (12th ed., 1895); *Theory of Credit* (1894); *Bimetallism* (1894).

"Value," is defined by Macleod as an affection of the mind, and not as a quality of an object. "It is the desire of the mind toward something external; either to acquire it, which is positive value, or to get rid of it, which is negative value. When value or desire proceeds another step, and gives something to obtain its desire, it becomes demand. And all phenomena of value or exchanges arise from reciprocal demand."[1] Like Whately, he urges that inasmuch as all economic goods have but one quality, exchangeability, economics should be entirely devoted to that quality. It should be observed that while he makes value originate in demand, Macleod says that economics has no business with psychological explanations of demand: "Economics has nothing to do with impotent desires of the mind which have no external manifestation." Thus his analysis is highly objective.

As exchangeability is the only criterion of "wealth" recognized by him, he takes immaterial and incorporeal items into the category, and even criticizes the Physiocrats for limiting the concept of wealth to material goods. Macleod's emphasis of incorporeal goods has aroused some interest, but has had little effect upon the science.

Another idea stressed by Macleod is that of "negative wealth," under which head he puts credits. Every sum of money, he says, may be regarded as "the sum of the present values of an infinite series of future payments, or . . . an annuity. And these annuities are negative economic quantities." This idea has been favorably commented upon by the English mathematical economist, Jevons.

Macleod was an individualist and a free trader.

Superficiality and egotism mar Macleod's work. For example, he berates Ricardo for what he thinks a faulty rent theory, saying that it is Ricardo's idea that marginal cost determines price, but that it is price that really determines the margin of agricultural production. And he fails to see any reason for treating credits as claims upon wealth and offsetting them directly, instead of treating them as additions to exchangeable commodities. In a word, his point of view is a narrow, individualistic one, and his vision is obscured by omitting production and consumption from consideration.

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[1] *History of Economics*, p. 158.

Some Adherents and Similar Tendencies. — The American, A. L. Perry,[1] seems to combine the ideas of Bastiat and Macleod without making any improvements: Economics is the science of exchanges, or value; reciprocal demand constitutes value; the Ricardian theory of rent is erroneous; only specific duties for revenue purposes are justifiable.

Michel Chevalier (1806–1879), the French economist, appears to have been somewhat influenced by Macleod as well as by Bastiat.

Walter Bagehot, in his ideas on the scope of economics,[2] showed some affinity with Macleod's theories; but is not to be thought of as belonging entirely to the group now under discussion.

Jevons' value theory presents some similarity, and it also seems probable that Walras was influenced directly or indirectly by Bastiat and Macleod. Consequently, Cassel and other mathematical economists since 1870 have been affected. The Italian economist, Pantaleoni, in his *Pure Economics*, shows clear traces of Macleod's ideas.

One tendency of those who would limit the scope of economics is thus found among mathematical economists (notably Walras and Cassel) who desire to reduce everything to soluble equations of exchange. Another tendency appears in the thought of those who, without resort to mathematics, seek to avoid all ethical and philosophical complications, and to get rid of the clash between human wants and costs. Thus H. G.

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[1] *Elements of Political Economy* (1866).

[2] See below, p. 528.

Davenport,[1] an American, would have had economics take a purely individual standpoint, thereby reducing cost to the "opportunities" (utilities) foregone by entrepreneurs.

The common tendency of those who would thus narrow the scope of economics to an accountancy for market exchanges, is to deal only with quantities of goods exchanged, and to take for granted the prices or ratios of exchange without any real consideration of the causal forces which determine value. This they do by reducing value to "reciprocal demand," "reciprocal service," "alternative use," "rareté" or scarcity, or other question-begging relatives and equations.

Summary. — The writers thus briefly mentioned are alike in that they severely criticized the scope given to economics by Smith and Ricardo. Surely it is interesting to find a group, no matter how weak, which traces its descent directly from *Les Économistes* of 1750; and it serves to bring out the differences, sometimes forgotten, which existed between the economics of Smith and Quesnay. It is as if a separate branch from one of the two eighteenth-century roots of the tree of economics had made itself known by the different fruit which it bore. Had Whately, Bastiat, and Macleod had their way, economic analysis would have been simplified, and the scope of economics have been much narrowed. Only such aspects of production and distribution would have been included as would fall within the field of exchange, and consumption would have been practically excluded.

The group discussed in this chapter agreed in desiring to make economics a science of objective value, and to *confine it to exchange relations*. In accordance with this idea, they rejected the material concept of wealth: holding that anything which is exchanged is wealth, they included immaterial goods. Similarly, they rejected the labor-cost theory of value, and ***emphasized demand*** in their discussion of the determination of value. A ***mathematical slant*** is apparent in their thought, suggesting something of the approach later taken by Walras. And both

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[1] *Economics of Enterprise*, N. Y., 1913.

Bastiat and Macleod anticipated the Austrian School in some respects, concerning both value and interest, their discussion of the time element in connection with loans being noteworthy.

All were individualistic, *laissér-faire*, and optimistic.

The reputation gained by most of the earlier economists mentioned is so small that it may be well to point out that the main idea for which they stood is not an absurd one, but on the contrary is quite reasonable, as is demonstrated by its reappearance in such keen minds as those of Walras and Davenport.

In fact, in view of the difficulties and inconsistencies in which the complicated mass of Classical economic doctrine was involved, it is not surprising that the simplification of the science was proposed. The political economy of the day was built upon a mass of little understood premises and hypotheses, some of which were under attack by the Socialists. The labor-cost theory of value was breaking down, and the "shares" in "distribution" seemed to constitute an insoluble problem. John Stuart Mill's restatement was evidently not final, and political economy seemed to be drawing no nearer to the goal of becoming a true science. How easy, then, to give up the attempt to carry out the analysis based upon "wealth" in the social sense, and upon definitions of wages, interest, rent, and profits which did not conform to business usage, and to substitute therefor concepts based upon a private-business point of view. Instead of entering a maze of cost and utility analysis, the exchange-value economist would take the objective facts of market ratios without inquiring why. *Let wealth equal all exchangeable things; let production equal offering for sale; take consumption for granted, and in its place put demand. Thus could be built a limited but exact science, — a science of business or commerce.* This would be in the spirit of the original *Économistes.*

Of course, this statement carries its own criticism. Such a "science" would require another one to answer the numerous "whys" that would arise at every point. Like accountancy, it would take an extreme individualistic point of view and would fail to explain the phenomena of industrial society. It would suffice for the traders on a stock or produce exchange, but it would not be political economy or social science.

It would be interesting, were it possible, to trace the part played by Socialism in occasioning the movement described in this chapter. There can be no doubt that a desire to refute Socialistic doctrines was partly responsible for the abandonment of cost theories; and by beginning with market prices, taken to measure demand and supply (chiefly demand), troublesome questions concerning the rewards for the factors of production were eliminated from the discussion.

In this respect, the exchange-value economists resemble the subjective-value group (and especially the mathematical branch) which about 1870 attempted to reconstruct the science. Neither group was concerned with "Distribution," but both endeavored to determine value without regard to the factors of production and their "costs." Both were mathematically inclined; and both emphasized demand. The great difference lies in the fact that one attempted to develop a cold and thin theory of objective, market-place values; while the other, as we shall see, became involved in such psychological mazes that they hardly found their way as far as the market.

b. Critics of the Method

CHAPTER XXVI

CONCRETE-HISTORICAL CRITICISM IN GREAT BRITAIN

In introducing the historical critics who are to be taken up in this and the following chapter, it is important to observe that, while their attacks upon "method" are emphasized, they were more than mere methodologists. A few would be considerable as economic theorists. Most of them are notable as critics of the "scope" of economics. Indeed, the historian might be justified in presenting at this point a chapter dealing with those who, instead of seeking to narrow the scope of economics, desired to broaden it by including all forces, motives, and conditions which have affected the development of man in society. Such has been the tendency of the "historical" schools of thought. Their outstanding characteristic, however, has been their proposed method, and therefore, while bearing in mind their significance as critics of the scope of the Classical economics, we present them here primarily from the former standpoint.

One of the most just criticisms of the English Classical School concerns the abstract character of its reasoning. In order to weigh rightly this criticism, however, it is essential to observe that it has at least two aspects, and that they vary in their importance. Thus it is one thing to set up a number of abstractions and then to proceed as though they were the concrete facts; but it is another matter to cut away certain complications with the idea of ascertaining more clearly what would happen without them, consciously providing for the reintroduction of such complications as required. Too often, a thinker begins with the second mode of procedure only to become blind to the complications, and so to end in the narrowness and absolutism which characterize the first type. But this all too frequent outcome need not blind one to the legitimacy and the advantages of the second. It has, however, blinded certain critics in whole or in part; and, as will appear, the valid and the invalid, the conscious and the unconscious abstraction, have been assailed without discrimination.

Some of the reasons for the abstract character of the early political economists, English and French, have been referred to in discussing those men. For one thing, the material and machinery for effective concrete investigation were deficient. History was inadequate; statistics likewise. Even had the material existed in abundance, there is, perhaps, some force in Leslie's point that the canons of induction had not been developed, that branch of logic being then an inferior instrument. The outline of the science had to be developed in order to cause a demand for materials to complete and correct it. More positively, the methods of the other sciences were influential. In the natural sciences, the more abstract and deductive methods of astronomy were the pattern, while the speculations of moral philosophy gave the more immediate background. Furthermore, the nature philosophy dominant at the birth of political economy begot a tendency to doctrinal absolutism that easily resulted in undue abstraction: *laisser faire* was made a law of nature, applicable in all times and places, — and forthwith its existence in the shape of free competition came to be assumed as more than an hypothesis.

To be sure, there is much historical matter in the *Wealth of Nations*, and Smith's method is by no means entirely deductive. And, following Smith, Malthus introduces the results of travel and wide historical reading in his *Principles of Population.* But in both cases the facts were introduced chiefly to illustrate *a priori* conclusions.

This tendency to undue abstraction reached its height in the Ricardian school, and at about the same time there came a reaction and criticism. In France, Sismondi contributed to this. It has already been pointed out that nations whose circumstances differed from those of England — especially Germany and the United States — took issue with generalizations which did not fit their concrete conditions. Accordingly, the Nationalists, including such men as List and Carey, arose as critics who attacked not only the doctrines but also the scope and method of Classical economics. This line of objection and others, were then developed and given a broad, scientific setting by the German Historical School.

In the present chapter, are to be traced similar developments in the land of Smithianism and Ricardianism. It should be pointed out in advance, however, that the writers to be treated do not form a "school" as did the German historical economists. Their work was sporadic, and, as will be seen, was scattered over a long period of time.

Though merely to be mentioned here, the importance of the example set by Darwin and Spencer about the middle of the century, needs to be remembered. The careful study of facts was stimulated by Darwin's work on the law of struggle for survival; and Spencer's *Social Statics* (1850), treating of the evolution of society through natural law, gave further impetus to the historical idea.

John Craig and John Rooke may be passed over with a word: The latter was optimistic, somewhat inclined to refer to history, and criticized Ricardo for overlooking temporary and concrete things;[1] the former in his *Remarks on Political Economy* (1821) argued against the doctrine that wages and profits must vary inversely, appealing to history for evidence. Craig also was critically inclined toward the Ricardian wage and rent theories.

Richard Jones. — Richard Jones (1790–1855) may be named as the first important rebel. His particular point of attack was the Ricardian doctrine of rent, which he assailed in vigorous terms in his *Essay on the Distribution of Wealth and on the Sources*

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[1] *Principles of National Wealth* (1825).

of Taxation (1831).[1] All land rents he divides into two classes: peasant rents and farmers' rents. The former are determined solely by bargain between the proprietor and a set of laborers who are chained to the soil, and use their small capital to get a bare living. Jones' contention is that farmers' rents deserve the exclusive attention given to them only as a scientific problem affording mental gymnastics; if the number of people concerned be considered, peasant rents are far and away the more important, — in the past they have prevailed everywhere, and are the predominant form of rent now (1831).

The abstract assumptions of Ricardo's teaching are pointed out as follows. If (1) lands were first appropriated by those willing to bestow pains on cultivation, and (2) if there were free access to uncultivated lands, the theory would hold; "but the past history and present state of the world yield abundant testimony, that it neither is, nor ever has been, a practical truth, and that the assumption of it as the basis of a system of political philosophy is a mere fallacy." [2] Jones further states that Ricardians make the "visionary" assumptions that (3) while there is unoccupied land, no rent, except in proportion to superiority over such land, exists, and that (4) rent is never the immediate result of cultivation. Jones also denies that rent increases only through the resort to inferior agricultural investments, his argument being easily triumphant, — as he sees it, — since he denies diminishing returns on the ground that improvements in the arts of production invalidate it.[3]

That these criticisms do not touch the heart of the theory of rent will be readily recognized. Properly interpreted, the third Ricardian assumption is correct as a long-run tendency, and Jones seems to be in error in putting the fourth assumption into the mouth of Ricardo. His criticism of diminishing returns, however, brought out the necessity for a distinction between the historical law and one good at any given time. His chief service in this connection is that he called men's attention to the fact that frequently what is called rent is "contract rent" not *economic* rent; and that, in general, he pointed out that the rent theory as commonly stated rests upon certain abstractions which limit its application.

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[1] Vol. I. No other appeared.

[2] *Distribution of Wealth*, Chap. I.

[3] *Ibid.*, Chap. I, p. 199.

In this same work, Jones shows that where peasant rents obtain, the interests of the landlord and society are not opposed.

He also criticizes the wages-fund theory, as will appear later.

Something of Jones' purpose and method are revealed in the following excerpt: "If we wish to make ourselves acquainted with the economy and arrangements by which the different nations of the earth produce or distribute their revenues, I really know of but one way to obtain our object, and that is to look and see." [1] And in 1833, in addressing the Indian cadets, he said: "We must get comprehensive views of facts, that we may arrive at the principles that are truly comprehensive" — otherwise "general principles" would have no generality. This spirit is to some extent illustrated in an article on "Primitive Political Economy of England" published in the *Edinburgh Review* for 1847. Here he gives an account of Mercantilism which is still worth reading.

Jones was little known to the outside world, but after 1859, when his *Literary Remains* were published through the activity of Dr. Whewell, he powerfully affected the minds of many English students.

Shortly following Jones' criticism, came that of the American John Rae (1834) to which reference has already been made.[2] On the basis of Bacon's *Novum Organum*, he formulated certain canons of inductive science, and showed that Adam Smith's thought was not truly inductive.

Walter Bagehot (1826–1877), banker and son of a banker, and editor of the *Economist*, was an admirable combination of student and man of affairs. Though more inclined to follow Ricardo than any other writer to be mentioned in this chapter, he was kept from undue abstraction, and his great service was to show the relation between facts and theories, especially in reconciling economics and history.[1]

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[1] Introductory Lecture at King's College, *Literary Remains*, p. 569. Professor Marshall has pointed out that Jones did not sufficiently distinguish between generality of conception and method on the one hand, and generality of doctrine on the other. ("Old Generation of Economists and the New," *Quar. Jr. Econ.* XI, 116.)

[2] Above, p. 386.

Bagehot's only notable thought on the material of pure theory concerns the entrepreneur or employing capitalist. The functions and importance of this productive agent are stated in some detail, and Bagehot was in advance of English economists in this matter. He insists that the costs of production are entrepreneur's expenses, of which he gives a peculiar and erroneous analysis.[2]

His greatest positive contributions to economic thought lie in the field of money and banking.

Our chief concern with Bagehot, however, lies in his treatment of the method and scope of political economy. For one thing, he limited the application of the science to conditions such as prevailed in a well-developed exchange economy: "The science of Political Economy as we have it in England may be defined as the science of business, such as business is in large productive and trading communities." This science he recognized as a product of developments dating from the Industrial Revolution. There had been a preëconomic age, when the assumptions now made would not apply.

He was among the first of English economists to appreciate the idea of evolution in connection with social science. (In these matters Sir Henry Maine was to Bagehot what Savigny was to the German historical economists.) This fact appears clearly in his work on *Physics and Politics* (1872), in which he discusses the evolution from a preëconomic to an economic age. In this same work he brings out the force of custom as limiting competition.

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[1] Bagehot's writings are as follows: —
International Coinage (1869).
Depreciation of Silver (1877). Reprinted from *Economist*.
Lombard Street (1873).
Economic Studies, a collection of his essays, published 1880.
The English Constitution.
Essays on Parliamentary Reform.
Physics and Politics (1872).

[2] *Economic Studies*, chapter on "Cost of Production."

In fact, Bagehot states that there are three valid objections to the English political economy: it is too often put forward as explaining the principal — or even all — causes of wealth in all societies; it is too abstract; there is not enough verification. Moreover, he saw that competition did not always work for the best interests of mankind.

But Bagehot did not desire to abandon either the deductive method or abstraction. "The process by which physical science has become what it is, has not been that of discarding abstract speculations, but of working" them out. More verification is needed. Rightly understood, the historical and abstract methods are not in conflict. The complexity and ceaseless change of modern economic life make a complete record of industry impossible; statistics are a "scrap of scraps."

Though an admirer of Ricardo, Bagehot was not blind to that writer's tendency to reason about abstract things as though they were real: "He [Ricardo] thought he was considering actual human nature in its actual circumstances, when he was really considering a fictitious nature in fictitious circumstances." [1] Of James Mill he says: "He would have shuddered at our modern conception of Political Economy as a convenient series of deductions from assumed axioms which are never quite true, which in many times and countries would be utterly untrue, but which are sufficiently near to the principal conditions of the modern world to make it useful to consider them by themselves."

Leslie. — In several respects, the successor of Richard Jones was the Irish economist, Thomas Edward Cliffe Leslie (1825?–1882). He was educated at King William's College, Isle of Man, and Trinity College, Dublin, where he was greatly influenced by the lectures of Sir Henry Maine. In his writings, he carries Maine's historical method over into political economy. He was also a reader of Comte, and knew the German Historical School through the works of Roscher and Knies.

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[1] *Ibid.*, p. 157.

Leslie's chief work is collected in two volumes of essays: *Land Systems and Industrial Economy of Ireland, England, and Continental Countries* (1870); and *Essays in Moral and Political Philosophy* (1879). His positive contributions concerned prices, wages, distribution of precious metals, and agrarian problems. His attack on the wages-fund theory will be mentioned in another chapter.

But Leslie's significance lies in the negative or destructive work he did, notably his opposition to abstract, *a priori* methods in political economy. Ricardo, he says, in his "laws" of natural wages, profits, and prices, ignored the essential difference between stationary and progressive societies. Had the economists, for example, in place of reasoning from an assumption, examined the facts, great inequalities in wages, even within the same occupation, would have been recognized. In Leslie's eyes, as in those of the German Historical School, man is not a mere exchanging animal — a personification of an abstraction; "he is the actual human being such as history and surrounding circumstances have made him, with all his wants, passions, and infirmities."

Pure deduction, he held, had betrayed Ricardians into "enormous fallacies" — fallacies from which Smith's element of induction had saved him — such as the doctrine of equalized wages and profits, and the theory that the rate of profits cannot rise except by a fall in wages.

Leslie strove valiantly to dispel what he termed "the ancient mist of realism," that is, the practice of confusing several ideas in one word. Thus he argued that the "wages fund" was an imaginary category; that "private interest" is merely a collective term for a number of individual wants, wishes, and tastes which vary with time and place; it is confused, too, with the phrase, "desire for wealth," which, in turn, stands for a multiplicity of ideas.[1] Even such a word as "emigration," Leslie shows, has been used to confuse a healthful movement such as is effective in raising wages, with an ineffective and harmful one resulting from evil institutions.

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[1] *Land Systems*, pp. 85 ff.

The opinion that political economy had been prostituted to the ends of class interest was pretty clearly expressed by Leslie. Smith, he says, could not have foreseen how " 'the progress of opulence' would govern the interpretation of his doctrines, or how the system he promulgated as the system of liberty, justice, and divine benevolence, would be moulded into a system of selfishness by 'the private interests and prejudices of particular orders of men.' "[1] Again he states: "Instead of a science of wealth, they give us a science *for* wealth."[2]

This broad-minded economist vigorously opposes the hedonistic utilitarianism of the economists of his day. Happiness cannot be the ultimate and only test: if it is better to be a sad philosopher than a merry fool, as, according to Mill, all men of elevation admit, then there must be something more desirable than mere happiness. Leslie thinks that "the progressive improvement of living creatures" is the best purpose the world contains.

He does not, however, escape one of the weaknesses of the Historical School. The negative character of his work has been mentioned, and his tendency is to leave us without definite conclusions. Political economy to him was "an assemblage of speculations and doctrines which are the result of a particular history." He believed that "no complete and final philosophy of life and human aims has been constructed; that the world abounds in insoluble problems, and that man's ideal of virtue is both historical and progressive." In short, Leslie was inclined to deny any validity to economic "laws."

It is not true, however, that he denied a place to the deductive method: "by *combining* the closest observation of phenomena with the boldest use of speculation and scientific hypothesis,"[3] other sciences had progressed. His whole contention is admirably formulated in the following quotation: political economy's

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[1] *Essays*, p. 149.

[2] *Land Systems*, p. 89.

[3] *Essays*, p. 378.

"fundamental laws ought to be obtained by careful induction, that assumptions from which an unreal order of things and unreal uniformities are deduced cannot be regarded as final or adequate; and that facts, instead of being irrelevant to the economist's reasoning, are the phenomena from which he must infer his general principles, and by which he ought constantly to verify his deductions." [1] This may be profitably compared with Senior's views.[2]

It is to be remembered that final judgment can only with difficulty be pronounced concerning Leslie's thought; for the work which was to have set forth his ideas systematically was lost while in manuscript form. This severe blow is known to have hastened his death.

Ingram. — John Kells Ingram (1824–1907) was, like Leslie, an Irish economist in Trinity College, Dublin; and his views are in many respects identical with his countryman's. His chief works are an address on *The Present Position and Prospects of Political Economy* (1878), and *A History of Political Economy*, originally published as the article on Political Economy in the *Encyclopædia Britannica.* Ingram complains that the Classical doctrines are "homogeneous with the school logic, with the abstract unhistorical jurisprudence, with the *a priori* ethics and politics, and other similar antiquated systems of thought." [3] They are too individualistic, unmoral, and consider exchange value too exclusively. We must base our studies more on modern physics and biology. The old abstract formulæ that all men desire wealth and dislike exertion, must be given up: "The laws of wealth must be inferred from the facts of wealth, not from the postulate of human selfishness." However, "reflective analysis" will be continually used: ascertained truths respecting human nature may be used as guides; and, occasionally, a deliberately instituted hypothesis may be legitimate.

Ingram was an outspoken follower of the philosopher, Auguste Comte, from whom he professed to draw his inspiration, though he was perfectly familiar with the German Historical School.[1]

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[1] *Land Systems*, p. 358.

[2] See above, p. 344.

[3] *History*, p. 240.

Toynbee. — Arnold Toynbee (1852–1883) should not be forgotten among the concrete-historical critics. A young man when he died, his views had scarcely ripened, and his fragmentary writings sometimes show signs of haste and even inconsistency.[2]

All his work was colored by an earnest and enthusiastic desire for social reform, and he made a special study of poverty and the labor problem, frequently addressing labor meetings. He was a pioneer in settlement work.

The final collapse preceding Toynbee's untimely death was brought on by one of his numerous speeches, this particular one being directed against the doctrines of Henry George.

Toynbee shows the relativity of the doctrines of the Classical School, making a survey of industrial history and bringing out the effects of the local setting upon the thought of Smith, Malthus, and Ricardo. He then urges that democracy has made man deal with the question of a better distribution of wealth; economists must answer the question, whether the mass of workers can raise themselves under present conditions of competition and private property. Ricardo and Henry George answer, no. He cites statistics showing that real wages have risen, to "disprove Ricardo's proposition that no improvement is possible." In stating that interest tends to fall, Ricardo, he says, had overlooked the possibilities of expansion in the field of investment; and he denies the Ricardian laws as to the tendencies of rent, wages, and profits.

Toynbee shows his optimism in believing improvement compatible with the present social order, urging that since 1846 free trade, factory legislation, trade unions, and coöperative societies had caused higher wages. He hopes much from moral progress and self-help, and also advocates an extension of government ownership and public housing. He is not, however, a Socialist, for he accepts private property and repudiates all confiscation and violence.

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[1] His position is most clearly and concisely stated in his preface to the English edition of Ely's *Introduction to Political Economy*, London, 1891.

[2] His published writings are embraced in a volume of *Lectures* containing essays on "Ricardo and the Old Political Economy," "The Industrial Revolution," and popular addresses on "Wages and Natural Law," "Industry and Democracy," "Are Radicals Socialists?" etc.

Some noteworthy characteristics of his thought appear in his emphasis of the distinction between theory and practical science or art; of that between what is and what ought to be; of the force of custom; and of the relativity of human nature — "it slowly changes, and is modified by higher ideals."

His stand on the point of method may be summed up by stating that while criticizing the overuse of deduction, he saw no real opposition between it and the historical method.

Thorold Rogers. — Finally, Professor James E. Thorold Rogers (1823–1890) must be mentioned to complete the account of the earlier historical reaction in England. Rogers was in spirit somewhat more akin to Jones and Bagehot than to Leslie and Ingram, with their greater emphasis on ethics. Thus he more nearly followed the Classical doctrines, while making a departure in the direction of careful historical and statistical investigation.

His best-known work, the celebrated, though not uncriticized, *History of Agriculture and Prices in England* (1866–1882), is a monument of patient research. Others are, *Manual of Political Economy* (1868); *Six Centuries of Work and Wages* (1884); *The First Nine Years of the Bank of England* (1887); and *The Economic Interpretation of History* (1888).

Rogers took up economics under Cobden's influence, and was also affected by Bastiat; therefore he might be classed with the Manchester School in so far as that school's peculiar tenets are concerned. He was opposed to what he believed to be the Ricardian doctrine of rent, however, laying emphasis upon the situation element and upon the fact that a movement from more to less fertile lands is not shown by history. Indeed, Rogers was very scornful toward Ricardo and his followers. The following quotations show his spirit: "By this historical study, I began to discover that much which popular economists believe to be natural is highly artificial; that what they call laws are too often hasty, inconsiderate, and inaccurate inductions; and that much which they consider to be demonstrably irrefutable is demonstrably false. . . . Two things have discredited political economy — the one its traditional disregard for facts; the other, its strangling itself with definitions." [1]

Summary. — It would be a serious error to fail to remark sufficiently upon the differences among the writers mentioned in this chapter. From the point of view of method and of relation to the Classical political economy, however, there is considerable unity among them. Thus, without exception, they show some appreciation of the historical method, though Bagehot would so limit the definition of political economy as to make more room for abstraction and deduction than the others. The influence of Sir Henry Maine has been noticed, being marked and direct in the case of Leslie and of Bagehot.

In accord with this historical attitude is a common revolt against abstraction. All would limit it in some way or other. All call for more verification, — more concreteness. All criticize the economists, though Leslie and Rogers go far in defending Smith, and Bagehot is inclined to follow Ricardo in some matters.

In each case, some one or more particular doctrines of the Ricardians is attacked in a monograph or essay. Not one accepts the wages-fund theory; all but Bagehot assail it. The same general opposition can be observed regarding the Ricardian theory of the relation between wages and profits. Jones, however, largely concentrates his criticism on the rent theory; Bagehot, on cost of production; Leslie, on the abstract assumptions, like that of a universal desire for wealth, and on the wages theory; Toynbee, on the movement of wages and profits; Ingram, on method.

The group is characterized by a rather clear tendency to optimism. All its members are either critical or hostile to Malthusianism. Jones and Toynbee reject what they understand as the law of diminishing returns. Holding that social institutions are potent in the field of distribution, as they were inclined to do, there was ground for hopefulness. Three of the later writers, at least, believed in the relativity and progress even of "human nature" and morals themselves.

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[1] *Econ. Interp. of Hist.*, Preface.

These same three men — Leslie, Toynbee, Ingram — desired a close relation between political economy and other social sciences.

As a group, they deserve an honorable place in the history of economic thought. Though they left no important general treatise,[1] and their main significance is negative, they supplied a much-needed corrective to English political economy. They stood for breadth or concreteness, or both. True, with the exception of Bagehot, they entertained vain hopes for the establishment of a new political economy; but what they really achieved was progress toward a better and more humanitarian economics.

[1] Rogers' *Manual* is little more than a primer.

CHAPTER XXVII

THE GERMAN HISTORICAL SCHOOLS[1]

During the middle years of the nineteenth century there arose in Germany an almost violent reaction against the dominant economics of Smith and Ricardo. This reaction found its chief expression in criticism of the philosophy and the methods of the earlier economists. It came about somewhat in this way.

Circumstances Giving Rise to Historicism. — Important developments had recently taken place in the world of thought outside of economics. Among the more remote of these was the philosophy of Hegel.[2] Hegelianism as a social theory regards the course of culture as an unfolding of the human spirit, as a sort of inherent self-development moving in an innately determined cycle. It contains a remarkable idea of evolution, — though not of evolution in the Darwinian sense, — and its influence is apparent, as will be seen, in the thought of at least one of the Historical School.

The economist and political scientist, Lorenz von Stein (1815–1890), was influential in applying Hegelian ideas to economics. A professor at Vienna from 1855 to 1888, Stein was a stimulating teacher and writer who combined a knowledge of French Socialism, and a realization of the interrelation of philosophy, economics, and law, with a considerable touch of the historical idea. He may be regarded as transitional from German Classicism to a more advanced historical and social point of view.[1] He was a pioneer in the development of the concept of society as distinct from the state.

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[1] In what follows, the historical method, as such, is emphasized. Several of the Historical School were keen theorists and wrote valuable works dealing with economic theory; but their significance for this chapter lies in their revolt in method.

[2] Hegel's *Logic* was published, 1812–1816; *Philosophy of Right*, 1820. See *Encyclopædia Britannica*, "Ethics": "the essence of the universe is a process of thought from the abstract to the concrete; . . . the history of mankind is a history of the necessary development of the free spirit through the different forms of political organization."

Of more immediate importance were developments in jurisprudence and philology. In the former science, the work of Eichorn and Savigny was of notable effect. These men taught that juristic systems are of relative validity only; that they are the product of the social conditions in which they arise; and that what is just and proper at one stage may be the reverse at another. And at the same time, in the domain of the languages, the laws of comparative philology were being formulated, so that in the evolution of words and the methods of tracing that evolution there were suggestions for a comparative method of studying economics.

Bases for the new movement were also laid in the social and political developments of contemporary Germany. The *Zollverein* had been established in 1833, and German nationalism was on the rise. New and complicated industrial problems had come, especially the labor problem, and these clamored for a solution which the Classical School did not afford. Meanwhile, the Socialists were criticizing the existing social order and insisting upon the relativity of the institutions of property and inheritance. A confusion of conflicting ideas prevailed, while the old leaders, as Hildebrand said, were silent.[2]

Müller and List had already expressed nationalistic ideas, and had made a limited use of historical comparison; but they were partisans, and their historical knowledge was imperfect. Already the characteristic tendency of several German economists to emphasize nationality, moral forces, and the place of governmental activity, has been observed. What the members of the Historical School did was to take all these tendencies, and, acting under the stimuli just mentioned, to formulate them in a broad, scientific way, while concentrating attention upon the problem of method.

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[1] Stein wrote *Socialismus u. Kommunismus des heutigen Frankreichs* (1843), *Lehrbuch der National Oekonomie* (1858), and other works.

[2] *Die Nationalökonomie der Gegenwart und Zukunft.*

General Nature and Main Branches of the Historical School. — The thinkers of the new school saw that economic life is not isolated from political and social life, but has close connections with all civilization; that it is not the same with all men, but varies in different societies and nations under different circumstances and at different times. They revolted against the one-sided and rationalistic doctrines of their predecessors, and proceeded to formulate an "historical method" for political economy.

It is essential to an understanding of the historical movement in Germany, to distinguish between the older group which originated that movement, and the younger group which carried the tendency further, even going to extremes.

The older group was largely, though not entirely, negative in its thought, *in so far as method was concerned.* Its members were attacking and tearing down the faulty abstract-deductive methods which they found predominant, and, while they formulated a method of their own, and their spirit of free investigation had most valuable positive results, still the negative aspect of their work was very large. They did not deny the existence of laws in economics, but they attacked *absolutism* and *abstract* deduction from *ideal postulates.*

The younger group sought to develop and apply the historical method further, and in so doing they took a positive stand that the older group would not have sanctioned. They, too, carried on a negative work; but this had been largely done for them, and in their several ways they took it as their task to get more positive results from a pretty exclusive application of their method. They differed from the older group in that they went so far as to deny the existence of non-empirical laws in economics. As will appear, they finally underwent a modification of spirit in the direction of greater breadth.

When, therefore, the "Historical School" is referred to in a general way, we should mean a very broad movement embracing all those economists who emphasize the relativity of laws and institutions, the inductive method of reasoning from concrete historical data, and the interrelations among human motives and among the social sciences.

The Older or More Negative Historical Group. — First among the German historical economists came Wilhelm Roscher (1817–1896), professor at Göttingen and Leipzig. Roscher thoroughly understood the Classical School, and in his positive theoretical writing was at one with it. Perhaps as a result, he was the author of one of the few well-balanced German treatises on economics. In his now famous *Grundriss zu Vorlesungen über die Staatswissenschaft nach geschichtlicher Methode* (Outline of Lectures on Political Science according to the Historical Method), published in 1843, however, he laid down the following program:[1] —

(1) Political economy is a science which can be explained only in the closest relation to other social sciences, especially the history of jurisprudence, politics, and civilization.

(2) A people is more than the mass of existing individuals, and an investigation of its economy cannot, therefore, be based upon a mere observation of present-day economic relations.

(3) In order to derive laws from the mass of phenomena, as many peoples as possible should be compared. Ancient peoples, having run their full course, are peculiarly instructive; and similarities between the old and the new are especially fruitful.

(4) The historical method will be slow to praise or blame economic institutions, for there have been few that have been entirely good or entirely bad for all peoples.

Accordingly, Roscher denied *absolute* truth as to general economic laws: "general principles" are necessarily incomplete abstractions. He would have recognized only national economics, holding that each people and each age has its own peculiar economy. The economist should thus confine himself to the statement of rules of government which are applicable to his particular economy, and are based on a study of various stages of industrial evolution.

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[1] Vorrede (preface). A full translation may be found in the *Quarterly Journal of Economics*, October, 1894. On Roscher see also the excellent article by Oncken in Palgrave's *Dictionary of Political Economy*.

Roscher shows clear evidence of the influence of Hegelianism.[1] The history of a nation is the unfolding of the human spirit: it is a cycle, repeating itself in different ages. The province of economics is to determine the laws of this process from the economic point of view. This idea is probably to be regarded as having a taint of error, for there is no proof of the existence of any such cultural laws as it assumes. It is surely over-idealistic to regard environmental conditions as mere disturbing elements in a self-development cycle, as Roscher sometimes seems inclined to do.

The next apostle of the historical method was Bruno Hildebrand (1812–1878), whose book, *Die Nationalokonomie der Gegenwart und Zukunft* (The National Economy of the Present and Future), appeared in 1848.[2] Hildebrand writes brilliantly and clearly, but his profundity seems much less than Ingram, for instance, ascribes to him. His criticism of Socialism is admirable, but he shows a lack of thorough understanding of the founders of the Classical School.

Hildebrand opens with the explanation that his work is an attempt to break the way for an historical direction and method in economics, a reform similar to that already made in philology.

Smith, Hildebrand says, erred, like the Mercantilists and Physiocrats before him, in attempting to build a theory which would apply to all times and places. Though Rau had denied this, on the ground that national lines are recognized by Smith, he did not meet the objection: "The cosmopolitan character of the Smithian school is not to be sought in a denial of the existence of states, but rather in the fact that it applies its doctrines to all states and peoples equally, considering the state only according to its external boundaries — as a mere fragment of the whole mass of humanity — and ascribes the same validity to its laws everywhere." [1]

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[1] Veblen, "Gustav Schmoller's Economics," *Quart. Jr. Econ.*, 1901.

[2] Vol. I appeared only. Hildebrand promised others. While he lived many years and wrote other works, he never fulfilled this promise. I will not go so far as to say this shows inability on his part, as some have done, but simply observe that we do not have his complete thought and our judgment must contain some reserve.

The Classicists forget that man, as a social being, is always a child of civilization and a product of history, his wants, his character, his relations to goods and men being ever changing. Moreover, they are atomistic, making the individual the end of society, and holding that society itself is based upon an exchange contract, private advantage being regarded as the source and bond of the community. Then, too, they slight the moral problem of the human race, a course which leads to materialism. Even if immaterial things are recognized, they are not given the slightest effect upon economic doctrine. On the other hand, it is a merit of the Socialists that they have emphasized ethical factors.

Hildebrand believed that the present money economy is only transitional to a more complete stage of development which he called credit economy.

Karl Knies (1821–1898) was the most thorough and logical expositor of the historical method. His work, *Die Politische Ökonomie vom Standpunkt der geschichtlichen Methode* (Political Economy from the Standpoint of the Historical Method), appeared in 1853, with a second edition containing some additions in 1881–1883. It was dedicated to Roscher. The title of the second edition, it is important to observe, was changed to read, "Political Economy from the Historical Standpoint."

Like his fellows, Knies attacks absolutism in theory. No economic laws can be declared absolutely final, for they concern points in a "constantly unfolding evolution," and can do no more than reflect a progressive manifestation of the truth. "The truth of all theories which have their foundation in empirical life rests upon concrete hypotheses. Relativity in the validity of their conclusions or judgments is a necessary result of the circumstance that those hypotheses do not remain identical nor occur constantly in all times, places, and circumstances."[1] *No complete parallelism between the past and the present exists.* Knies dwells upon the fact that the concept of private property has been a changing one, and that self-interest often conflicts with the social welfare. And he calls attention to the fact that various ideas as to what kinds of labor are productive have prevailed. Valuations themselves rest upon such shifting hypotheses. He shows in some detail the circumstances which have given rise to the various kinds of economic thought, developing the idea of relativity between economy and economics. He believes in a certain relationship between the industrial stage and the development of the science.

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[1] P. 28, note.

The next question is, what method shall be followed in each case? By method, Knies means the manner in which fundamental facts are ascertained, demonstration is made valid, and conclusions are established. The method applicable in any scientific discipline stands in the closest relation to the character of the science; therefore, progress in the science affects the method, and *vice versa.*

Knies criticizes Roscher for the unusual and unscientific way in which he uses the term, "historical method," stating that Roscher devotes his attention to the exposition of historical material, method meaning to him merely a general point of view. A beautiful and fruitful field is opened alongside of political economy, but economic doctrines remain uncorrected.[2] The chief problem remains, which is to establish the causal connection between ever-changing phenomena. When the question concerns phenomena, and the laws of phenomena, in which likeness and difference appear, Knies says that *we cannot expect to establish identities but only analogies:* "Only laws of analogy can be won, not laws of absolutely equal causation."[3] We are concerned with clarifying the regularly occurring analogies in economic phenomena. In this connection, Roscher is again criticized for believing that a comparison of historical

[1] 1st ed., p. 286.

[2] P. 32.

[3] P. 346.

conditions which are merely similar, not identical, will lead to the establishment of laws of cause and effect.

Knies shows a usual tendency of the German Historical School by differentiating natural and social phenomena, and by laying strong emphasis upon the modern importance of social institutions in connection with the distribution problem.

The foregoing economists had no idea of a revolution in economics, and were by no means averse to theory and deduction, as the character of their work shows. As much has already been indicated concerning Roscher; and Knies wrote acute theoretical works on money and credit, telegraphs, railway transportation, and statistics. In these books there is no one-sided application of historical-descriptive methods. Rather one wonders if, after all, there is much difference between the methods of the older members of the Historical School and those of the men they criticize; and no little misunderstanding has arisen on this very point.

Knies, it will be remembered, changed the title of his work to read "from the historical standpoint" instead of "from the standpoint of the historical method." This he did to disarm just such criticism as still follows the school, and to show that he advocated no exclusive, one-sided method. In the new edition he wrote: "Taken in the true methodological sense, therefore, the designation, 'historical method of Political Economy,' would be unreservedly permissible only if historical investigation were to be recognized as the sole task of the science. Though we may strongly desire to refer to history and stand upon it in a well-considered way, yet we must never on that account allow to pass unrecognized the difference between economic history and political economy, nor that between the special tasks of the historian and the economist."[1]

As a matter of fact, the older group of the German Historical School stood first for a criticism and attack upon the narrow, error-breeding abstractions of the Classical School; and secondly, and positively, for a theory of evolution and for a spirit of free and full investigation.[1] Roscher believed that by the study of history we can find a "firm island of scientific truth which may be accepted in the same manner as the adherents of different systems of medicine all admit the teaching of mathematical physics." He believed that there are general principles or laws, only they are to be applied to particular cases with the aid of statistics of local conditions.[2] Knies denied, not that any laws exist, but that there are laws like those of the external universe, e.g., physics and astronomy.

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[1] Introduction, p. vii.

This group will be remembered as standing for a new spirit and a fresh point of view. It cannot be maintained that their effect was merely negative, for in America and England and Italy and France the stimulus of their thought was a virtual emancipation, and produced profound results. Moreover, the significance of their part in leading up to the more positive historical thought which followed, is to be remembered.

Closely affiliated with the older Historical School were the German economists, Schäffle, Kautz, and Schüz.

The Younger or More Positive Group. — In the course of a few years, another group of thinkers appeared, however, and determined to apply the historical method, as they conceived it, in a thoroughgoing way to concrete studies. They even refused to recognize a difference between the purposes and methods of economic theory and economic history. Chief of these was Gustav Schmoller, at the end of the nineteenth century one of Germany's leading economists. In 1895 Schmoller wrote: "The older historical political economy has repeatedly desired to turn too quickly to account the lessons of universal history; we are now aware that laborious inquiries into the details of economic history can alone supply the right basis for the study of history in its economic and socio-political aspect, and for the satisfactory empirical establishment of national economic theory."[1] In these words, the difference between the two groups is suggested, and also, perhaps, a certain degree of impatience with the older group for not following the inductive method to such lengths as the members of the younger group in their various ways desired.

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[1] The spirit of the group appears in the following quotation. Speaking of unrealism Knies said: "The difference is that the idealists demand conditions which we, according to the known and knowable fundamentals of the real and personal conditions in economic life, must designate as impossible; and that, in conflict with the content of life, they wish to make their absolutely complete conditions stationary, while we . . . proceed from and upon the ground of positive results and with means the reality of whose existence is confirmed by experience: we can point to goals which we view like the forms of the present which are already attained as points in a constantly unfolding evolution." (*Pol. Oek.*, 2d ed., pp. 42 f.)

[2] It is worth while recalling that L. Cossa was a disciple of Roscher, and Cossa's sympathetic stand toward Classical doctrines is well known.

To get the setting for Schmoller's work it is necessary to turn aside for a moment to note a new development in German economic thought.

Beginning about 1863, Germany was powerfully shaken by a social agitation which brought out the younger group and gave the whole historical movement a new prominence. In 1872 the now famous *Verein für Socialpolitik* was founded.[2] This society was based upon the recognition of a social problem, and stood for participation in political activity for social reform. It gave rise to much controversy, and brought new life and purpose to the historical economists.[3] At this time, however, they became confused with those advocates of social reform — sometimes called "socialists of the chair." The movement was thus a broad one, embracing most of those in revolt against the Classical School. In it were those who advocated the inductive method, those who emphasized ethical factors, and the adherents of realism. Among these different phases of the movement, however closely associated they may be, the idea of the historical method, as such, must be kept distinct.

Schmoller, now deceased, was born in 1838, became professor at the University of Berlin, and was active in the *Verein*. He saw in economic history and statistics the means for establishing a methodologically complete empiricism. By this means alone could the foundation for a concrete theory of political economy be derived. The deductive method was not entirely excluded by Schmoller, — though at first he gave it a very small place, — but was rejected only in so far as it is connected with *abstraction*. As his thought matured, Schmoller came to hold that the proper method is a combination of induction from historical and statistical observation with deduction from the known properties of human nature. Natural environment, ethnology, and psychology were all appealed to; and in his last and most important work, *Grundriss der Allgemeinen Volkswirtschaftslehre* (1901–1904), these factors play an even larger part than purely historical observation. All these things are the factors which determine the industrial situation at any given time. Psychology, for instance, must be introduced in order to explain motives; while the facts of climate and geological structure place limitations.

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[1] *Handwörterbuch der Staatswissenschaften*, article on "Volkswirtschaft," § 9.

[2] Cf. Schmoller, *Ueber einige Grundfragen des Rechts und der Volkswirtschaft*, 1875. See also below, pp. 668–669.

[3] *Ibid.*

Certainly Schmoller's later writings show slight evidence of Hegelianism, his idea of evolution being more nearly like Darwin's.

Meanwhile Bücher in his *Entstehung der Volkswirtschaft* (1893) has taken a point of view similar to Bagehot's in England,[1] holding that while the historical method leads to a theory of the laws of economic evolution, the deductive methods of the Classical School are valid for developing the laws of a modern economy. Like Bagehot he would stress the modernness of economics, saying it is a thing of the present complex money-and-division-of-labor economy. Here abstraction and deduction may be necessary.

Schäffle (1831–1904), although he perhaps belongs in the older group, may also be mentioned as an important recent economist who had affinities with the school. A notorious characteristic of his is an overextension of the analogy between the body politic and a physical organism.[2] He stands for a large amount of government intervention, and is rather sympathetic toward Socialism.[1] Nor among the later adherents of the school should Brentano and Held be forgotten; while Conrad, Miaskowski, Nasse, Schanz, and Schönberg are among those who combine the historical method with a considerable use of deduction.

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[1] See above, p. 528.

[2] *Bau und Leben des sozialen Körpers*, 1875–1878, 4 vols. See *Econ. Jr.*, XIV, 138, for convenient biographical and bibliographical note.

Schmoller in Germany, however, and Ashley in England, are the clearest representatives of the younger group, and Émile de Laveleye [2] may be considered as a French representative; the others are mentioned not as forming a compact or closely related group, but as displaying similar tendencies in method.

Historicism in the Early Twentieth Century. — As applying to the first decade of the twentieth century, the notable tendencies of the Historical School may be summed up as follows: [3]

(1) But small space is given to the general principles or theory (the *Grundlegung*), the importance of the historical study which usually follows being emphasized.

(2) Relatively slight attention is given to the theory of value, especially to its subjective aspects.

(3) Individualism and the principle of self-interest are greatly limited by the introduction of general anthropological and historico-philosophical considerations. Under the last head would be included their ideas concerning the relativity of theories and institutions, the importance of ethics, social institutions, etc.

The general tendency, then, was to return from the extreme reaction of the later historical movement, and to adopt a better-balanced method, — in a word, toward a recognition of the fact that each method has its place. This change is seen in Schmoller's later thought and is expressed in Bücher's position.

It seems fair to say that the movement initiated by the

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[1] *Die Quintessenz des Sozialismus*, 1875. Schäffle grew more critical of Socialism and is not to be thought of as having been a Socialist himself.

[2] See Ingram, *Hist. of Pol. Econ.*, ed. of 1923, p. 214.

[3] See Ashley's article on "Historical School" in Palgrave's *Dictionary of Political Economy*. Professor Ashley has been one of the most extreme members of the Historical School.

German Historical Schools had clearly ceased to exist as a distinct factor by the time of the World War. Something of its spirit, however, lived on in the new nationalism and Institutionalism which sprang up in that troubled time.

Summary and Critical Estimate. — From the standpoint of pure theory, the largely negative character of the earlier group of the German historical economists, and the weakness of the method advocated by the later group, are evidenced by the fact that after two decades or more, the founders of the school had directly accomplished little beyond the preliminaries of the introduction of systematic reforms; and, indeed, aside from their valuable studies in industrial history, the work of the later and — for a time, at least — more radical group was polemical and speculative. Directly, it led to results which were largely negative. (Indirectly, however, as has already been emphasized, the thought of the school was one of the great liberating and stimulating forces of the nineteenth century, bringing positive results in the economic theory of all the advanced nations.)

The reasons for this result are not far to seek: strictly interpreted, the method itself has inherent weakness; it is, in fact, itself one-sided. The adoption of the exclusive use of the historical method as urged by the more radical group would devitalize the science by depriving generalizations of their validity. As Hasbach and others have pointed out,[1] a purely inductive method — one according to which deductions are made only from premises derived from observation — will not suffice for a science of exchange among men. Suppose that we make a long series of observations concerning a phenomenon, and as a result formulate a rule; suppose further, that we verify this rule; is there not still the question, what is the cause? The historical law must ever be an empirical one based on an ever incomplete experience.[2]

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[1] See article by Lexis in *Die Entwickelung d. deutschen Volkswirtschaftslehre* I, i, 38 (Leipzig, 1908).

[2] Menger in *Untersuchungen über die Methode der Sozialwissenschaften*, 1883, made a most acute criticism along this line.

It is the recognition of this fact that accounts for the general tendency to deny the validity of economic laws which characterizes the school. Even Ingram criticizes it on this score, showing that there may be laws in change and development, and "that there exist between the several social elements such relations as make the change of one element involve or determine the change of another." [1]

In more positive criticism, the Historical School — at least that of Schmoller and Ashley — has sometimes overlooked the existence of the power to judge of causes from a knowledge of the motives of men and the action of environment. There are certain psychical qualities, certain physical laws, and perhaps certain tendencies in social organization, which may be taken as fundamental. These are like the axioms of geometry. By referring to them, economics may become more than a branch of historical learning, for thus one may determine the causes or sources of the observed regularities, and so allow economics to partake of a scientific character.

In fine, both inductive and deductive methods are needed.[2] The words of an eminent adherent of the latter method state the truth with admirable moderation: this method "recognizes the utility — for technical reasons — of tracing causal connections, not only from special to general, but also, *for the sake of experiment*, from general to special. It thereby often discovers links in the chain of causes which were, of course, present in the complex, empirical facts, but which were there so deeply inwrapt that they would hardly, if ever, have been discovered by a purely inductive method." [3]

The service of the Historical School has been to counteract an undoubtedly over-abstract tendency. The concrete realities of time and place have been stressed. In applying the principle of least sacrifice, some economists had forgotten that what one people or time considers a gain, another may look upon with indifference or regard as a loss. So it is also with the "at any given stage of the industrial arts" qualification of the "law" of diminishing returns.

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[1] *History of Political Economy*, p. 205. This the older historical group, though differing as to the nature of the relations, would not deny.

[2] See above, pp. 21 f.

[3] Böhm-Bawerk, "Method in Political Economy," *Ann. Amer. Acad.*, I, 263. (Italics are the writer's.)

The school has broadened the conception of human motives by emphasizing the interaction of non-economic and economic motives. The interrelation existing among the several social sciences, has accordingly been kept in mind. It has clearly shown the fallacy of extreme individualism and *laisser faire.*

Finally, the followers of the Historical School are to be thanked for valuable studies in economic history, — studies from which data have been obtained for verifying and correcting the theory of the Classicists.

In connection with the two preceding paragraphs, it may be added that the Historical School has been a force tending to broaden the *scope* of Economics.

3. THE LOGIC

The following chapters deal with some developments in the history of economic thought which concern the logic of particular points made in the economic theory of Smith and his followers, — with the correctness of the reasoning of the Classical Economists. The writers to be discussed are notable not so much for their emphasis on a different underlying system of philosophy and ethics or for the adoption of new methods, as for their direct criticism of the economic doctrines of the Classical School.

It is difficult to classify these thinkers, and to select the most representative and important. Their criticisms vary in depth and essentiality and point of view. Now it is the rent doctrine, again the classification of productive agents: now the theory of wages, and again that of value. From one point of view, they might be grouped accordingly as they criticize from an ethical or non-ethical standpoint. Or the subjective element might be made the basis for classification. But a simpler course has been taken in merely discussing a few of the more notable and typical critics and theories.

Not a few of the important criticisms of the class now to be discussed have been mentioned as incidental to the thought of those whose opposition proceeded from a philosophical or methodological standpoint. Lauderdale and Rae, for illustration, criticized Adam Smith's discussion of *division of labor* and its advantages: and Sismondi, Müller, and others, pointed out the evils which flowed from such division. Then Sismondi began a notable series of criticisms concerning income and *consumption*. Friedrich List attacked the labor theory of value, — as did Bastiat and Carey, — and proposed to amend the Classical doctrine of *capital* by including immaterial wealth, a proposition in which Say and others had preceded him. The concept of *wealth* was a continual battleground, and might be made the subject of a volume. Senior was a notable critic of the Ricardian theory of *value*, and censured the economists for lack of precision in defining their field and terms. Jones, von Thünen, Carey, and Rodbertus, in their several ways, subjected the Ricardian theory of *rent* to adverse criticism; the various members of what might be called the concrete-historical group in England denied the validity of the Ricardian doctrine concerning the relation between *wages* and *profits;* and the German Historical School, along with others, introduced further criticism by broadening the treatment of economic concepts and *motives.*

In fact, almost a volume might be written describing and analyzing the bearing of the historical method upon economic theory, largely by way of modifying the *premises.* This school, too, together with such predecessors as Sismondi and Müller, called attention to the element of friction and delay in the working of the economic "laws" of the Classicists.

The Malthusian principle of *population,* implied in Smith's thought and accepted by Ricardo and Mill, is perhaps the most criticized theory which has become part of economics. On the one hand, the optimists assailed it; numerous non-optimistic critics found this or that particular fault with it, on the other.

All this, too, leaves unmentioned the criticism involved in such isolated points as Senior's abstinence theory of *interest,* Lassalle's idea of conjuncture, and the like.

Naturally, therefore, not all points can receive *separate* extended treatment in a general history of economic thought. The aim here is to stress those which have actually stood out separately, — as the "wages-fund" doctrine did — and which at the same time have had the most important place in the development of economic theory as it was left by Ricardo, Senior, and Say. The student can readily find for himself, with the aid of the index an account of the development and criticism of value, wealth, rent, and other subjects.

CHAPTER XXVIII

LAUDERDALE AND HERMANN: EARLY CRITICISM OF THE THEORY OF CAPITAL, PROFITS, AND VALUE

The theories of Adam Smith and Ricardo did not clearly set forth the nature and function of capital as an independent factor of production, and accordingly contained no clear-cut and distinct analysis of "profits." They held to an objective cost theory of value in which labor, though not the sole element, was overemphasized. Naturally, too, consumption received scant attention.

Two groups of criticism, then, are suggested: on the one hand the theory of capital and income needed development; on the other, there was need for a critical examination of value theory which should bring the subjective factors into due prominence. Criticisms along these lines were essayed by Lauderdale, who has already been mentioned in another connection, and the German economist and statistician, Hermann. Naturally, certain corollaries of the theories attacked were also open to objections, some of which are set forth in this chapter.

Lauderdale's Criticism of the Theory of Capital and Profits and His Doctrines of Consumption and Value.[1] — *Capital and Profits.* — Lauderdale at once takes Smith to task for his treatment of capital, his point being that that factor had not been given due importance as a distinct element in production. Of his own work he says: "Land, Labor, and Capital are separately treated of as the sources of wealth; — an opinion which, though it has been announced by some, and hinted at by others, does not seem to have made on any author so strong an impression as to be uniformly adhered to in the course of his reasonings."[1] Capital, he argues, is productive in itself, its services being twofold, namely, to economize labor in producing the results already obtainable and to make the production of new results possible. Accordingly, the profit on capital arises either from its supplanting a portion of labor which would otherwise be performed by the hand of man, or from its performing a portion of labor which is beyond the reach of the personal exertion of man.[2]

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[1] See also above, pp. 381–383.

Now this conclusion is most important; for the notion that capital operates merely by putting labor in motion and adding to its powers implies that industry and the employment of labor are limited by capital. The true analysis, however, suggests the inference, that a country cannot be benefited by the possession of a greater portion of capital than can be employed in performing and supplanting labor, in the production and formation of those things for which there exists a demand.[3] And he goes on to argue against "parsimony" as creating a more than requisite quantity of capital. This is not only a radically different conception of capital, its function and income, from that found in Smith's thought; but also its bearing upon the wages-fund doctrine which soon gained such prominence, is apparent. With Lauderdale's theory that doctrine would have been impossible.

Value. — In accord with Lauderdale's general emphasis of productivity and demand, his theory of value shows some development toward a proper correlation of utility and cost. Value, he says, is the necessary characteristic of individual riches. The essentials of its existence are: usefulness and pleasure to man, together with a certain degree of scarcity. The following illustrative passage makes his idea clear: —

> "Water, it has been observed, is one of the things most useful to man, yet it seldom possesses any value; and the reason of this is

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[1] *Inquiry into the Nature and Origin of Public Wealth* (1804), p. 10.

[2] *Ibid.*, pp. 161, 203.

[3] *Ibid.*, p. 204. Note the conception of an absolutely predetermined demand and of the possibility of general overproduction which is implied. Cf. above, pp. 383, 395.

evident: it rarely occurs that to its quality of utility is added the circumstance of existing in scarcity; but if in the course of a siege, or a sea-voyage, it becomes scarce, it instantly acquires value; and its value is subject to the same rule of variation as that of other commodities." [1]

Lauderdale criticizes Petty, Harris, and Smith for seeking an absolute standard of value. Moreover, he quotes from the *Wealth of Nations* to prove Smith's inconsistency in making labor the measure of value, showing that it is stated or implied at various points in that work that labor differs in value at different times and at different places.[2] It must be admitted that although Smith's use of the word "price" instead of "value" at points saves him, yet his not infrequent confusion of value in use with value in exchange lets Lauderdale's shaft hit.

Consumption.—Lauderdale was a pioneer in the discussion of the economic significance of consumption, pointing out the relation of the subject to value, and dwelling upon the effects of varying degrees of elasticity in demand.[3] To understand riches (individual wealth) and their variation, he says, we must study the interrelations between demand and supply, and all the indirect effects of changes in value of one good upon another. As the tastes of individuals differ, so men will differ in the extent to which they will go in renouncing a commodity when its supply is diminished; while, in turn, the prices of different commodities will vary according to the degree in which they seem necessary. Changes in demand are discussed in a similar fashion, something of the importance of necessity, habit, and taste being indicated. Then Lauderdale examines the effects of changes in supply and demand upon the order of consumption, using meat, wine, and mustard to illustrate different elasticities in demand. These commodities would be affected very differently: the change referred to "would have very different effects in altering the proportions betwixt the quantity and the demand of each of these articles, so it must alter, in a very different ratio, the value of a given quantity of each." Some undesirable results of an unequal distribution of wealth are also mentioned.

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[1] *Inquiry into the Nature and Origin of Public Wealth* (1804), pp. 15–16.
[2] *Ibid.*, p. 30.
[3] See *ibid.*, pp. 66, 85 f., and elsewhere.

The Theories of Hermann and Other German Economists, Chiefly concerning Capital and Undertakers' Gains. — From among the numerous German economists of the early nineteenth century, von Thünen and Hermann stand out clearly as the two most acute and original theorists. Of the two thinkers, von Thünen was undoubtedly the more original, but Hermann's work was based upon a far wider reading,[1] and, being in closer touch with the current of economic thought, appears to have exerted a greater influence upon his contemporaries. This relative result was doubtless due in part to the clear, concise style in which Hermann wrote, and, perhaps, to the absence of mathematical formulæ.

In some respects, Hermann was a follower of Adam Smith, and he generally begins his discussions with a statement of Smith's views on the point involved; but his philosophy and his theories of value and distribution are so at variance with those of the *Wealth of Nations* that he must be classed as a critic. Since his criticism is non-ethical, and is directed against Smith's logic, he hardly falls among those who opposed the philosophical and ethical system.

Friedrich Benedikt Wilhelm von Hermann (1795–1868) published his chief work, *Staatswirtschaftliche Untersuchungen* (Investigations in Political Economy), in 1832.[2] In his preface he sounds a note of criticism of existing economics, and presents a most interesting statement of the weak points in the science. In general, he warns his readers against the notion that it is a complete and perfect science. It is too closely related to life, with its continual change, for that. In fact, he states that economists had arbitrarily limited their field by excluding certain objects.[1] Again, in accord with a common German idea, he argues that to conclude that individual interest always leads to public advantage goes too far.

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[1] The following are some of the writers to whom Hermann refers: Aristotle, Hegel, Physiocrats, Steuart, Smith, Malthus, Lauderdale, Sismondi, Ricardo, M'Culloch, Jakob, Hufeland, Sartorius, Nebenius, Müller, Storch, Lotz, Rau, von Thünen, Read, James Mill. The careful study of and influence by James Steuart and Lauderdale are especially interesting to the English reader.

[2] Revised and enlarged edition in 1870. The following references in the text are to the pages of the first edition.

The more particular shortcomings, as Hermann sees them, are the following:

(1) The lines of demarcation between the several classes of society had not been clearly drawn, and the faulty distinction between productive and non-productive occupations is especially pointed out as an illustration of this weakness.

(2) The theory of price seemed to him to be full of defects:

- (a) The factors which enter into the determination of a particular price had not been sharply and completely indicated;
- (b) The treatment of the equalization of prices, or comparative price, had not been adequate;
- (c) The distinction between exchange value and price, he refers to as "unsatisfactory";
- (d) He states that there was need of an analysis of price into its ultimate elements, so that the cost of the finished product would be traced back through its component materials to wages and profits.

(3) Hermann also complains of the narrow interpretation of the concepts, "goods" and "income." Say and Sismondi, he says, had made valuable suggestions, but had not carried them out consistently.

(4) Finally, consumption is mentioned. Here numerous writers had touched upon the abuse of the current interpretation of income; but they had failed to develop their ideas or to discuss the effects of consumption upon exchange and economics in general, as their varying treatment of such problems as are presented by absentee landlordism and parsimony, manifests.

Aside from its intrinsic interests, as a statement of the case against the political economy of the day, the foregoing criticism is of value in that it outlines the contents of Hermann's book fairly well. Only the part dealing with capital and profits has been withheld, in order that it may serve as an introduction to the discussion of Hermann's theories concerning these subjects.

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[1] Cf. below, p. 561.

Passing over his theory of value for the moment, the point to be stressed in Hermann's thought is the theory of capital and the correlated criticisms of the Classical wages and rent theories.

Capital. — In his preface, Hermann states that previous discussions of capital had been deficient in their treatment of its origin, nature, classification, and working; while the existing theories of profits were marked by shortcomings in that they did not explain with sufficient accuracy either the determination of that share in distribution, or its relation to wages. It may be inferred from his remarks that he thought that Ricardo and M'Culloch had done the best in this regard, but that the former was excessively abstract and the latter was even more so. Smith's conception of capital was good, but had not been carried out consistently. Most writers had followed Smith; though Sartorius and Hufeland had shown some independence, both of these writers distinguishing between the usability of a good as capital and its capacity to satisfy wants directly. The latter had made capital embrace all goods which *can* be used for production, including those which for the moment await productive application (p. 47).

But, to hasten to the point, Hermann tells us that capital rightly means all sources of income which endure and have exchange value. Thus he approaches the determination of the capital concept from the standpoint of income, and income in the sense of utility (p. 57). Smith, he says, had made income mean the excess of product over cost, or *net* income. But income is really the use of property; and "production, in relation to the yield of capital for producers, is nothing but an exchange, through the agency of capital, of the direct usufruct of one property owner's goods for a more convenient form" (p. 57).

Accordingly, all houses and lands are to be included in capital, so long as they are durable sources of utility income, and have exchange value.

Hermann's classification of these economic categories which are related to capital is as follows (p. 59): —

Property: —
- I. Immediate consumption goods.
- II. Capital: —
  - 1. Use capital (yielding satisfactions directly).
  - 2. Industrial capital (yielding satisfactions indirectly).
    - (a) Loan capital.
    - (b) Production capital.
      - (1) Fixed.
      - (2) Circulating.

Thus he follows Say and Ganilh in distinguishing a so-called "use capital," or what we would today rather call durable consumer's goods, the category being illustrated by such public property as highways, gardens, and buildings. "Immaterial capital" is also admitted, consisting of trade secrets, special privileges, etc. "Personal capital," however, he rejects on the grounds that it cannot be exchanged, is not a sufficiently durable source of income, and that the motives which lead to the production and education of men are different from those which obtain in the production of goods.

Manifestly there is nothing in Hermann's definition of capital to prevent the inclusion of land, and it is in this point that its peculiarity is most sharply apparent. Land being a good which endures and yields an income, is capital (p. 48). To the usual arguments in favor of a distinction between the two factors, Hermann replies that cost is not an essential aspect of capital, the fundamental thing being a stock of goods which furthers production; and this is just as true of land as any other agent. Moreover, to obtain the fruits of the earth, labor must be expended, while the operation of fixed capital depends upon the forces of nature, so that there appears to be no fundamental difference on that score (p. 50). He believes, too, that the income on improvements is inseparably bound up with that from the land. Against an idea sometimes expressed by Smith and others, Hermann argues that land is not a monopoly, but merely exists in scarcity like fixed capital (p. 153). This early economist, then, anticipates a tendency which has recently threatened to divide economists in the United States.

It remains to be observed that Hermann clearly expressed the idea of capital as an abstract fund of wealth; for he says that above all one must distinguish the object in which a capital is expressed from the capital itself (pp. 335–336). The latter goes on undiminished, regardless of the consumption of its products; machines are used up, but not necessarily capital, for normally the value of the product yields a replacement fund (p. 337). Even irregular losses are shifted from capital to income by means of insurance. Here, again, theories which have gained some prominence of late years are anticipated.[1]

Rent and Wages. — Hermann's notion of capital led him into conflict with several ideas held by Smith and other members of the Classical School. For one thing, it was inconsistent with the Ricardian doctrine of rent. Like others who have taken the same course, he regarded rent as a percentage of the value of the land, which, once the land is sold, obeys the laws of interest. But perhaps more noteworthy is his criticism of the wages-fund theory.

The downfall of the wages-fund theory is the subject of the next chapter. It came in the seventies. But more than forty years earlier, this German economist, in a clear, concise fashion, advanced those arguments which were to overthrow it. Some statements made by Smith, and the doctrine of M'Culloch, and Rau, says Hermann, make capital the source of wages, and the wage rate depend upon the proportion of population to capital. But, even granting that wages depend upon such a proportion to circulating capital, nothing follows as to capital in general; a greater percentage might be invested in fixed capital (p. 281). Again, the number of those laborers who furnish personal services and are paid directly from income, is too great to be overlooked. As a matter of fact, wages are paid out of the value of the product. The undertaker buys labor, not to consume it, but to sell what it produces. From the income of the consumer, then, comes the true compensation of the laborer's services. The growth of the aggregate capital, however, does have an indirect influence in that it causes a demand for more products.

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[1] Cf. below, p. 889.

Hermann resents the idea that the capitalist-undertaker, or enterpriser, nourishes the labor class. Rather, he simply uses labor to procure a more advantageous sale of part of his capital. Labor and capital mutually facilitate the transformation of their separate services into forms more suitable to each, and stand on equal terms as to economic function. In fact, it was a fundamental error of Smith's that he at points considered capital merely as the maintenance of laborers. Hermann argues that this is false as far as fixed capital is concerned; and so much of circulating capital as is expended upon material, buys not merely labor, but uses or utility (*Nutzungen*).

Undertakers' Gains. — After his theory of capital and the criticisms of rent and wages doctrines which flowed from it, the next great point in Hermann's theory is his treatment of undertakers' gains, that is, the income received by the entrepreneur as such.

At this point is found an interesting illustration of the close relation between industrial environment and economic thought. In England, the growing importance of a capitalist-employer class, the existence of relatively large commercial and industrial concerns, and the use of "joint stock," not only meant that a considerable class was receiving an income that was hardly explainable either as "rent" or as wages, but also suggested to Smith and his followers the idea of profits as a return on business capital. Profits, to these writers generally, meant the revenue of capital (interest) plus a half-concealed something for management, though Senior's ideas differed somewhat from the common notion. But in Germany, industrial conditions were not so developed. Industry was generally carried on with small-scale units, and the handicraftsman who used his own capital and managed his own establishment was the prevalent manufacturer. Agriculture, too, was largely in the hands of peasant proprietors. Thus the function of the business undertaker — as the Germans called the entrepreneur or enterpriser — was relatively more dominant than in England. There was less income upon invested capital, — capital dissociated from management by its owner. Incomes consisted more largely of satisfactions or uses derived directly from products. Thus it would have been natural for German thinkers to emphasize both the function and the income of the undertaker, and that is what they did.

But meanwhile the English doctrines with their emphasis of capital had penetrated German thought, so that interest could not be slighted. The result was a rather well-rounded theory of profits, which, in its *addition of a clear-cut idea of the undertaker's gain to that of interest on capital, amounted to a contribution to economic theory.* Indeed, in these early German discussions about the functions and income of undertakers may be found many of the ideas that are now common in the debates concerning the nature of profits. It will be observed that the idea, common among French theorists, that profits are the wages of management of the entrepreneur, would, in so far as it influenced German thought,[1] produce a result similar to that caused by this environmental condition.

Hufeland was one of the earliest writers to show the German tendency [2] toward the separation of "profits" into interest and undertakers' gains, and the analysis of the business undertaker's functions. He made undertakers' gains consist partly of compensation for risk, and partly of a rent for the undertaker's talents and capabilities. And Rau (1826) emphasized the same point, regarding undertakers' gains as a peculiar income springing from the inner relation between capital and labor, in which the shares of both these sources cannot be separated.

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[1] Lotz, Jakob, Nebenius.

[2] *Neue Grundlegung der Staatswirtschaftskunst*, Vol. I, 1807.

Hermann made the subject clearer. Approaching the problem from the point of view of income, he reasoned (p. 204) that the business undertaker's proper income is a reward for the following services: (1) combining the factors of production, (2) evolving plans, (3) furnishing rare capacities and talents of supervision, (4) guaranteeing a fixed rate of interest while his own gain depends upon price fluctuations. And all these services, he added, vary with the amount of capital involved. The undertaker's gain, then, is the necessary reward for these services, cares, and risks. On the one hand, it is to be distinguished from the wages of labor, the compensation for exertion of a small-scale undertaker at some trade. On the other hand, the fourth service is not to be confused with a compensation for risk; for such a compensation is not income at all, but is capital, and must be saved against losses.

The amount of the undertaker's gain is determined by demand and supply as to capital (p. 208). The quantity of capital which owners of capital do not themselves wish to employ makes the demand for the business undertaker's services, while the number of those who seek to turn capital to productive employment fixes the supply. His services and income, then, being related to the amount of the capital involved, if a given gross profit (*Gewinn*) is assumed, the undertaker's gain varies with the amount of interest, the higher the interest the lower his gain, and *vice versa*. He may temporarily increase his gains by making such improvements or inventions as will lower costs; but when others learn of these improvements profits are lowered so as just to cover costs again.

The earlier period in the evolution of the German theory of undertakers' gains may be regarded as brought to a close in 1855 by Hans von Mangoldt (1824–1868) with his notable monograph on this subject, *Die Lehre vom Unternehmergewinn* (The Doctrine of Undertakers' Gains). He reviewed the previous theories and sought to prove the necessity of undertakers' gains on economic grounds. His own very eclectic theory made them consist of a premium for risk, wages of management, undertakers' interest, and undertakers' "rent." The interest included, was that arising from such capital as from its nature could not be lent or the undertaker's own capital; and the "rent" was a premium on "undertaking" ability. His work shows a leaning toward overminute analysis, not uncommon among the German theorists.

Consumption and Value.—In Chapter VIII, Hermann deals with the consumption of goods, showing evidences of Lauderdale's influence. He takes up the concept of consumption, order of consumption, consumption in relation to the employment of goods, in relation to the economy of the consumers, and in relation to political economy in general. The effects of parsimony, luxury, purchases abroad, etc., are dealt with; and several interesting charts or diagrams are presented to show the course of distribution among landowner, renter, laborer, and manufacturer, perhaps an echo of the Physiocratic analysis.

Hermann made an acute criticism of the labor-cost theory of value, his thought on this point being in several respects akin to that of his contemporary, Senior. Thus, he discusses more carefully than his predecessors the particular factors in value and price determination, analyzing demand and supply. Market price, under conditions of two-sided competition, is determined by demand and supply. Demand, however, depends upon three main factors: the use value of the desired commodity, the ability to pay of the one who desires it, — which factors form the subjective limits (*Gränze*) of price for the buyer, — and the alternative cost of its production, that is, the lowest cost of producing or acquiring the commodity in some other market (p. 74). These things set an upper limit to prices. On the side of supply, there are the following forces: the cost of the commodity, alternative sale price, and the exchange value of the commodity in which price is expressed. Thus a lower limit is set. In dealing with the cost factor, the interaction of price changes and costs are discussed (pp. 82–88). Though considering that for reproducible commodities cost is decisive, he gives considerable weight to utility, and makes an important place for demand.

Hermann's general criticism of the labor-cost theory of value proceeds from the idea that the quantity of labor is not directly related to the quantity of value in the goods in whose production capital figures; "but only indirectly, and in so far as the laborers can, by means of an increase or decrease in the supply of labor, work against the variation in the value of their subsistence [wages?] with the rate of profit" [1] (p. 131). Any good, to be a just measure of value, must vary in price directly with capital and labor, and to that end must contain both factors. Furthermore, he makes the five points which follow (p. 133):

(1) It is not true that goods which are not freely producible form a negligible quantity. Among them must be placed land, and through it most goods are affected. If a machine, even, contains labor, this is not to be thought of as passing into the product; only in so far as the machine is used up is it to be considered as raw material; on the whole, the labor and capital uses united in the machine are withdrawn from circulation and are merely bases of a usufruct.

(2) *a.* If labor cost determines value, and goods containing equal labor costs exchange on equal terms, it must follow, not merely that 2 x labor buys twice as much as x labor, but also that x labor always exchanges for x labor and no more.

b. But, *assuming that the rate of profits is everywhere equal,* a product must exchange for more labor than it contains. That is, a day's labor of a farm hand, if exchanged for a pair of boots upon which a day's labor had been put by the shoemaker, tanners, etc., involved in its production, would be securing not only that day's labor, but a capital use. "But if n labor in product A exchanges for $\frac{5}{4}n$ labor in product B, how can n labor in B at the same time buy $\frac{5}{4}n$ in A?" [2] If it be argued that materials and subsistence are necessary to make labor effective and that therefore past labor is used, it is thereby conceded that there is an element in production beyond labor, namely, the use of capital; and if the product has an exchange value in excess of the labor cost, its existence is explained by the fact that this capital use has not only value in use, but also exchange value.

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[1] I.e., counteract the tendency of wages and profits to vary inversely.

[2] Cf. the argument on Ricardo's theory of profits, above, pp. 303 f.

(3) If one overlooks or abstracts the capital-use element and regards it as equal in each product, labor may be thought of as determining; but, in fact, these uses are hardly alike in any two products.

(4) In truth, Ricardo's rule, as expressed by M'Culloch, merely says A = A and does not explain the essence of exchange value.

Conclusion. — There is no need for a detailed criticism of the views of Lauderdale and Hermann. The former was in error in positing a limited demand based upon an assumed body of "needs"; and his notion of the function of capital, while containing a correction of Smith's ideas, was crude. Hermann's chief mistake appears to be an undue minimization of the differences that exist among productive agents. First, he too nearly overlooks the significance of the question of directness of yield, and this causes him to include durable consumers' goods in his classification of capital ("use capital"). But chiefly this minimization is seen in his denial of the significance of cost differences between the factors which are ordinarily called land and capital. He virtually omits any recognition of the importance of the fact that the supply of land in general is limited, and that this is especially true for any one of the different grades of land. His treatment of undertakers' gains, too, is open to the objection of including payments for diverse functions,[1] and he is sometimes classed as one of those who attempted to combine the English and French theories.

The more modern tendency would be to classify a part of the rewards given to the undertaker by Hermann as wages and part as "pure profits."

The merits of the two writers have perhaps been sufficiently indicated.

The similarity between their views upon important points and the probable influence of the earlier author upon the other do not seem to have been recognized. Resemblances have been noted in the independent place given to capital, the subjective element in value, and the treatment of consumption. Both also point to the distinction between public and private wealth, Hermann undoubtedly following Lauderdale to some extent.

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[1] Mangoldt's theory is open to a similar criticism.

CHAPTER XXIX

THE DOWNFALL OF THE WAGES-FUND THEORY

During the space of a generation, roughly covered by the lifetime of John Stuart Mill, that method of explaining wage rates known as the wages-fund theory played an important part in the history of economic thought. Some account of this theory has already been given.[1] Though a faint trace of it may be found in Turgot's writing, it is an English product, dating from the time when capital and a capitalist class began to be of prime importance in industry. Following the Industrial Revolution there came a certain new dependence of labor upon capital — as advances of subsistence and direct aid to production — which the economists soon exaggerated. Passages from Smith, Ricardo, Malthus,[2] and M'Culloch [3] might be cited, showing a suggestion of the idea that wages depend on a wages fund of circulating capital, the two writers last named being clear and definite in their expression of it. Senior, as already seen, puts it quite clearly, and is commonly named as the father of the theory. But it was James Mill who stated the theory in a hard and fast manner, and his son, John, fitted a somewhat modified form of the doctrine into his restatement of the Classical political economy.

James Mill's statement of the doctrine was as follows: "Universally, then, we may affirm, other things remaining the same, that, if the ratio which capital and population bear to one another remains the same, wages will remain the same; if the ratio which capital bears to population increases, wages will rise. . . ." By capital, Mill means the food, materials, and instruments devoted to production.

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[1] See above, pp. 301, 311, 348, 454.

[2] *Political Economy* (1836), p. 234.

[3] *Essay on Population* (1st ed.), pp. 305 ff.; *Political Economy*, p. 379.

Passing over some early criticism in Germany [1] which had no influence in England, that interesting series of assaults by English writers which sapped and overthrew this dogma may be taken up at once.

Perhaps the first came from Richard Jones, who wrote in 1831. At this time the theory had not gained such prominence as it later attained, and Jones was chiefly concerned with rent; therefore his treatment was too brief to give him the honor of a decisive attack. Jones' words were as follows: "We should take a very false view of the causes which regulate the amount of their [the laborers'] earnings, if we merely calculated the quantity of capital in existence at any given time, and then attempted to compute their share of it by a survey of their numbers." [2] For, as laborers "produce their own wages, all the circumstances which affect either their powers of production, or their share of the produce must be taken into the estimate." These ideas were not expanded, and Jones' judgment appears to have had small effect.

A similar lack of effectiveness, so far as recognized and avowed, at least, attended the much more conclusive work of Francis D. Longe. Longe was an Oxford man and a lawyer, having been admitted to the bar in 1858. Through a connection with the Children's Employment Commission he became acquainted with the labor problem; in 1860 he published a treatise on the law of strikes; and this was followed, in 1866, by his pamphlet, *A Refutation of the Wages-fund Theory of Modern Political Economy.* He also published *A Critical Examination of Mr. George's "Progress and Poverty."*

Longe quotes passages from Mill and his follower, Fawcett, to show that they believe (1) in a definite fund destined for purchasing labor; (2) that the laborers form a group within which competition can distribute wages; and (3) that the factors controlling this distribution are demand and supply. These things Longe denies. Even as an abstract principle, he holds, the theory is false. The fallacy lies in treating the fund taken to represent demand for labor "as a sum which would all be spent in labor, notwithstanding the purchase of a part of the supply with a smaller portion of it than would represent the proper price of the part bought, as determined by the proportion between the whole supply and the money-measure of the original demand." Even if the circulating capital of a country were a certain per cent of its wealth, there is nothing to insure that the laborers *would* get all. And he shows that Mill falls into some confusion by using "demand," now as money demand, now as the quantity demanded. As to the existence of any such fund, Longe himself maintains that the mere psychical process of "destining" a thing cannot bring it to pass; it is demand in the sense of quantity of labor demanded that enters into the determination of the wage rate.

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[1] Above, pp. 354, 483, 562.

[2] *Essay on the Distribution of Wealth,* Chap VI.

The whole fallacy, he states, lies in a confusion of two funds: one consisting of the goods available for maintaining laborers during the productive process; the other, of the amount of wealth available for purchasing the product.[1] The former may come from the laborers' own resources or be borrowed, as well as be advanced by the employer directly; the latter might come from consumers, from the goods produced, or from the employer. It is the latter "fund" alone that is significant.

Mr. Longe sent copies of his *Refutation* to Mill and Fawcett, but it provoked no reply.

Two years after the appearance of Longe's pamphlet, another concise refutation of the doctrine under consideration was published, being found in the *North British Review* for March, 1868.[2] The article is unsigned. Its writer begins by stating that the fallacy of the wages-fund theory lies in its premise that everything which decreases profits thereby decreases the means of paying wages.

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[1] *Essay on the Distribution of Wealth*, Chap. VI, p. 47.

[2] Pp. 5 ff.

He calls attention to the fact that manufactures do not all receive a bare minimum profit, the inference being that wages could be increased by drawing upon surplus profits. More than that, he goes on to argue, a diminution of profits may lead to an increase in saving and capital. For one thing, the fund for paying wages is mostly drawn from the price of the product, and is reinvested without conscious effort. "A manufacturer will generally work his mill or factory to the utmost so long as he does obtain a profit; he does not voluntarily set aside a certain sum for wages, diminishing and increasing that sum according to profits, but he employs as many men as he can, and pays them what he must." In the second place, there is another class of savings, coming from investors, and this increases when the interest rate decreases. In short, the wages fund may increase either through higher prices or through lower profits.

This unknown writer sums up his criticism in the following words. "Our argument is briefly this: — Wages, like the price of all other limited commodities, depend on a conflict between the desire for the commodity, and the reluctance to sell it. Anything affecting either feeling as to labor will alter wages. The total desire, measured by the total sum paid for wages, may increase in consequence of large profits leading men to wish for an extension of trade, but it may also increase owing to increased reluctance on the part of the labourers to sell, leading the purchasers of labour and produce, one or both, to pay more, lest they should lose wholly, or in part, their profits, or the enjoyment of the produce." The price of labor is ascertained through competition, which establishes an equilibrium; but this does not explain the forces which determine.

Next, Cliffe Leslie deserves mention as taking up the cudgels against the wages-fund theory. His criticism appeared in two articles published during 1868 in *Fraser's Magazine*, one in May and one in July.[1] He held that there are no funds destined to employment as wages. Capital can emigrate and be shifted from one employment to another. Capital may be substituted for labor. The unequal distribution of the aggregate available for wages, moreover, might make wages much lower than if that aggregate were equally shared by employers. Or through combination, wages might be forced down. But even if there were such a fund, the question would still remain, what determines its amount?[1] Finally, competition does not work to distribute the "fund" among laborers so as to equalize wages and sacrifices.

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[1] *Land Systems and Industrial Economy*, pp. 87, 358 ff. It will be noted that articles by Thornton preceded these in course of time.

Leslie was acquainted with Longe's pamphlet, and at one point refers to it in order to make a criticism.

Meanwhile, Thornton had published some "Stray Chapters from a Forthcoming Work on Labor" in the *Fortnightly Review*. This was in the fall of 1867. Two years later the book itself appeared under the title, *On Labour*. In Book II, Chapter I, which contains his attack, Thornton begins with a criticism of the whole demand-and-supply theory of value as stated by the Classical economists. He then proceeds to argue his case against the wages-fund doctrine on this basis.

Fixity or definiteness, he says, is the essence of the supposed wages fund. But such a fund can have no existence save as an aggregate of individual funds, and such funds are far from fixed. Every employer, it is true, has a certain amount of money. But each may devote more or less to domestic expenditure, and so with buildings, materials, and labor. In any case, no one is bound to spend all he can upon labor. With such reasoning Thornton made short work of demolishing the idea of a definite sum of money set aside as a wages fund, — the idea commonly held at the time.

On this particular matter, Thornton is behind Longe in grasp and keenness of analysis. Moreover, as was pointed out by the American economist, Francis A. Walker, the fact that individuals have no definite funds does not necessarily prevent the existence of a social or statistical definiteness. Yet Thornton's attack took immediate effect. In the *Fortnightly Review* for May, 1869, Mill made his classic recantation, declaring that the wages-fund doctrine was a barrier to an important province of economic thought, — a "shadow which will vanish if we go boldly up to it."

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[1] In connection with this criticism Leslie mentions the article in the *North British Review*, March, 1868, p. 6.

It is not improbable that Mill had been gradually weakened by the attacks of Longe and Leslie, and by his sympathy with trade unions in their efforts to raise wages. His belief had been accepted from the Ricardians, including his father, and at a time when the labor problem was less acute and his sympathies less aroused. Moreover, his ideas on demand and supply were rather superficial, and were not based upon a thorough analysis. Then, upon the appearance of his friend Thornton's book, he decided to give up publicly. Just why the gates of his belief were opened with such a rush is more or less of a mystery, and not a few have surmised a lack of candor in dealing with Longe. An opinion favorable to Mill, however, seems most just, nor has any proof of dishonesty on Thornton's part been advanced.[1]

The next step in the controversy was Cairnes' attempt to revive the wages-fund doctrine. In his *Leading Principles of Political Economy* (1874), he argued that wages are necessarily paid out of capital, and that, under given industrial conditions, total wages must bear a definite relation to total capital. His reasoning assumes that profits (interest and pure profits) have a tendency to a minimum.

Then came Francis A. Walker's attack, an attack which was more constructive and suggestive of the true relation between wages and capital than was the work of his predecessors; though, like his predecessors in criticism, he directed his assault toward the idea of a wages fund in the shape of money, not clearly distinguishing capital from product.

"Given a certain body of labor employed," Walker asks

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[1] Cf. Walker, "The Wage-Fund Theory," *North American Review*, Vol. 120, pp. 94 ff. (1875). Walker's views were fully stated in *The Wages Question* (1876).

"what is it that determines the amount which the employer can afford to pay in wages? Is it the amount of capital at his command, or the value to be realized from that labor?" And his answer is, it is production which limits wages, and production is in its turn limited by consumption. Wages are ultimately paid out of the product of industry, and in so far as paid before the product is marketed capital merely advances the amount. In new countries, in fact, wages are mainly paid out of the product of current industry.

Walker makes a second point in regard to the effect of the number of laborers. The sum of possible wages is far from being fixed without regard to the number of laborers. On the contrary, their number and efficiency form an important element, and an increase in labor supply may result in a more than proportionate increase in the aggregate of possible wages. It is folly to postulate "other things being equal," for this cannot be when population changes.

As finally formulated in his *Political Economy* (1883) Walker's case is as follows: (1) Wages are not always advanced out of capital, but in new countries such as the United States are often paid directly out of product. (2) Even if wages were always advanced out of capital, the ultimate payment comes from product; for laborers are hired for the sake of product and profits, not for the sake of getting rid of a fund. (3) The amount of wages is related to the industrial quality of the laborers. (4) The amount to be paid in wages cannot be irrespective of the numbers of the laboring class: (*a*) an increase in population may be attended by such improvements in "the division of labor and the union of forces in production" as to increase product and wages without any increase in capital; and (*b*) when returns from land diminish with increased population, wages fall because *per capita* production is diminished, even though capital may be increased. Walker's argument is intimately related to his residual theory of wages which in turn depends upon his theory of profits (see below, p. 717).

The final word in this stage of the discussion has been said by another American economist, Professor F. W. Taussig. In his *Wages and Capital, an Examination of the Wages Fund Doctrine* (1896), Taussig presented a careful and accurate analysis of the relation of capital to wages, together with a history of the wages-fund discussion from its beginning to the close of the last century. His conclusion is that there is an element of truth in the wages-fund idea, and that to the extent that this is so, Walker's ideas are wrong.

The argument, briefly put, runs thus: real wages being properly the subject under consideration, it is apparent that, in a division-of-labor economy, laborers — and others — are supported chiefly by the product of past labor; for the reward of present labor is enjoyable goods, which, for the most part, exist only as the result of a long period of production. In any but the shortest periods, then, the resources of a community exist in the form of capital from which income in the shape of consumable commodities immediately flows; while the hired laborers of our industrial system, being dependent for their money income on a bargain with capital owners, do draw their wages from a sort of wages fund. This does not mean, however, an unalterable relation between real capital and real wages, but that wage earners get their money wages, and thus their share of real income, from what the capitalist class, including middlemen and bankers, find it profitable to turn over to them. Moreover, a limited degree of elasticity is allowed to wages by Professor Taussig's theory.

In a word, the significance of roundabout methods of production and our dependence upon past production for enjoyable goods, are made clear.

The whole wages-fund episode in the history of economic theory, while it has led to fruitful discussion and a clearer understanding of the relation existing between wages and capital, after all owes its existence chiefly to a confusion of thought. Perhaps springing from the industrial organization at the time common in England, the idea prevailed among economists that capital consists of money, or at least, consumers' goods in the hands of employers. This was the underlying notion of all those who took part in the controversy on this point, even down through Walker's day. A large part of capital goods was neglected, and its function in this connection left unanalyzed; while capital was mixed up with product, or goods for consumption. The forces of demand and supply, as they operate in the evaluation of labor, were not carefully and fairly analyzed.

As long as this idea obtained, false notions concerning the interrelation of wages and profits (interest) could easily prevail. Capital was thought of as a "residual claimant" from an ill-defined wages-plus-profits aggregate. The downfall of the wages-fund theory meant a forward step not only in the theory of wages, but also in speculation concerning capital and interest.

Undoubtedly, too, in the long and widespread sway of the wages-fund doctrine is to be seen the influence of class bias. It served to emphasize the prime importance of capital in industry and defend it from increased taxation. It also furnished the capitalist class with a ready argument against strikes: the wages fund being a fixed amount, what one union gained would necessarily be at the expense of another.

This doctrine was closely related to the tendency toward pessimism which was so common in the English Classical School, and its abandonment by the leaders of the school is significant as indicating a more hopeful outlook. The downfall of the wages-fund theory opened up a greater place for human arrangements in the shape of social reform in distribution.

VI. ATTEMPTS AT RECONSTRUCTION

The two preceding chapters have concerned certain criticisms of the dominant Classical economics which applied not so much to the philosophical basis or the method pursued as to the correctness of the reasoning — the logic. One further line of criticism of this last order remains for discussion; one which has been so ambitious, so sweeping, and, withal, so successful, that it is well to set it apart, and call it an attempt at reconstruction.

Down to about the middle of the nineteenth century, and somewhat beyond, the type of economic thought which was predominant in the leading countries, England and France, was centered upon objective phenomena, and built upon an idea of cost. It tended toward an emphasis of the limitations of the physical environment and of the expenses of producing material goods. There was considerable analysis of psychic costs, such as labor pain and abstinence, but, in the application, costs became the *expenditures* of the employing capitalist, depending chiefly upon the available *supplies* of the factors of production. There was some discussion of utility and much of demand, but the tendency was to treat demand as dependent upon objective material conditions, such as population and the supply of capital. Value was considered by the dominant school to be determined by "cost of production," in the sense just mentioned.

In viewing the struggle of man to gain a living from his physical environment, the Classical economists were chiefly concerned with the material obstacles to production. Accordingly, they tended to make economic value a function of the cost — mostly labor — of overcoming these obstacles.

At various points in the preceding pages, attention has been called to evidences that the significance of wants, utility, and the subjective side of value generally, did not pass unnoticed

All the time, indeed, though the fact was not appreciated, a leading point of difference in economic thought lay just here. But the dominant schools everywhere were little disposed to dwell upon subjective aspects, and psychology was slow in furnishing the basis for adequate analysis. Here, then, was an opportunity for reaction and even for a reconstruction of economic analysis.

1. SUBJECTIVISM AND MARGINISM

Shortly after the opening of the second half of the nineteenth century, several factors combined to occasion this reaction toward subjectivism. The Classical economics sank into some disrepute because of the narrowness and dogmatism which developed in it: it failed to adjust itself to times and places. One reason for this fact was its one-sided dependence upon material and objective considerations, which caused an almost continuous succession of opponents or critics to demand in one way or another that more attention be given to subjective factors — to the wants, choices, and volitions of man. Some dwelt upon the subjective side of value, emphasizing utility. Others stressed man's control over external forces of nature, or the significance of man-made institutions.

Particularly effective were the Historical School, with its criticism of the abstract absolutism of the exchange-value economics, and Socialism, with its doctrine of class struggle and its extreme labor-cost theory of value. Both schools were so extreme in their attacks that a reaction from their theories was both invited and facilitated. Their criticisms, however, were sufficiently well founded to necessitate improvement in the position occupied by the Classicists. For example, Socialistic attacks, with their extreme and illogical application of the Classical theory of value, stimulated economic thought to a deeper analysis: Marx's theory needed recognition of the part played by utility for its most effective refutation.

Finally, it may well be surmised that the development of psycho-physics showed the way to develop the subjective analysis, or at least called attention to its scientific validity. About the middle of the century, a physiologist, E. H. Weber (1795–1878) gave to the world some investigations concerning the intensity and duration of sensations or mental facts.[1] His results were elaborated and expounded by Fechner in 1860 (*Elemente der Psycho-Physik*), and have become known to every student of psychology as Weber's Law, or, sometimes, Fechner's Law. Observing that the greater the intensity of the original stimulus the greater must be the increase in stimulus in order to cause a perceptible difference in the resulting sensation, these investigators framed a principle as follows: In order that the intensity of a sensation may increase in arithmetical progression, the stimulus must increase in geometrical progression; or, to put it another way, within short periods, if the stimulus be continued in equal amounts, the intensity of a sensation is diminished. Such a principle, of course, necessitates a scale of excitation- or stimulus-values, with minima and maxima of perceptibility.

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[1] See Wagner's *Handwörterbuch der Physiologie*, 1842–1843, Vol. III.

Here, then, was the basis and the model for a law of diminishing utility. The principle suggests a scale of utilities, with an estimation of goods according to the intensity of the gratification-sensation of the last unit of consumption-stimulus.

The significance of the last or marginal unit of stimulus was apparent, and naturally suggested the way to make definite the vague concepts of total utility which had prevailed.

We have already noted that the idea of diminishing utility appeared in the thought of several early economists. Moreover, it seems impossible to say just how direct is the relation between this development in experimental psychology and the analysis of Jevons and the Austrian School. Progress in one science, however, gets "in the air," and soon influences others.

Nature of Subjectivism

It will be well at this point to discuss briefly the nature of "subjectivism," and its various manifestations in economic thought.

Philosophically, subjectivism means an emphasis on the primary importance of the subject — the ego — and his attitudes. It is not to be confused with any particular psychology;

for one may be a subjectivist and still consider the "subject's" psychoses to be determined in one way or in another.

In economics, subjectivism has come to mean an emphasis of man, the subject, as against those objects in his environment which are scarce, and an insistence that economic values are determined by human desires. The subjective economist must hold that the value of a good is not in any sense "intrinsic," and that it is not an absolute quantity of anything — such as labor time.

In practice, the subjective economists make the human want the ultimate causal force in economic life, and consider utility (which they may confuse with "want") to be the manifestation of the relation between goods and the wants which they gratify. They do not deny the reality of the object, or the existence of objective value; but they consider objective phenomena as secondary and dependent upon the subjective. This statement, the truth of which they may not realize consciously, is borne out by the fact that they consider economic value to be determined by "reciprocal demand," "degree of utility," etc. They all resort to a process of "imputation"; first they attribute subjective value to an imputation (by the subject) of utility to an object; then they "explain" certain objective values (e.g., capital goods) by imputing the value of one thing to another thing.

In practice, too, the subjectivist is apt to be (1) a hedonist, and (2) one who treats cost or disutility as purely negative.

As a hedonist, he considers pleasure the object of wants or desires, and assumes that men act in anticipation of pleasure. While the hedonist need not limit pleasures to the sensations which result from contact with material objects, the hedonistic economist is prone to do so, for he is dealing largely with exchangeable "goods."

Since he is seeking to establish a "science," he also seeks to measure degrees of pleasure, satisfaction, or "utility" (thus confusing "utility" with "pleasure"), and this leads him to treat pain, dissatisfaction, or disutility as being (1) separate from, and (2) merely negative to, "pleasure." This he does by reducing "costs" to terms of pleasures foregone — "opportunities" lost. And this, in turn, compels him to make his "subject" a sort of "economic man" who chooses pleasure, and weighs alternative "uses."

Finally, the subjectivist is in practice generally driven to individualism, since he finds in the individual the seat of pleasurable sensations and the faculty of deciding among alternative "utilities." (It is very difficult to consider any over-individual processes as an independent or decisive reality.) Moreover, in dealing with diminishing utility and degrees of utility, and marginal or final utility, the subjective economist comes to a very definite focus on the individual.

It should ever be remembered that "marginism" must center attention upon "points" — upon differences and degrees — and that in this it is opposed to the use of "averages" that was so common in Classical economic thought. In the last analysis, marginism is bound to find an individual, or a group compounded of identical individuals, whether it be at the margin of production or the margin of desire.

In short, while a subjectivist may not be a hedonist (and if he is, may be an idealist), — and while he may consider cost as coördinate with utility, and may even conjure up a "social mind" to supplement or control the individual's choices, — in practice such is not the case. The "subjective school" has sought to build up a market from individual choices among "utilities," and to derive market values from the rational subjective valuations of individuals.

It should be carefully noted that subjectivism involves assumptions concerning the nature of the "subject" — the nature of man, and his relationship to his environment and to society.

CLASSES OF ECONOMIC SUBJECTIVISM: MATHEMATICAL AND NON-MATHEMATICAL

In practice, two great lines of cleavage have divided the so-called subjective economists into different schools: (I) the mathematical economists, and the non-mathematical, or "psychological" economists; (II) those who give "cost" an important place in determining value, and those who do not.

(1) The "mathematical school" of subjective economists are, as the name implies, given to a large use of mathematics; but more especially are they characterized by a tendency to treat economic phenomena as (*a*) capable of quantitative expression, and (*b*) subject to independent variations. Not all economists who use mathematics have been subjectivists, but the typical ones have been, including, as we shall see, such men as Gossen, Jevons, Leon Walras, Launhardt, and Irving Fisher. Even those who, like Cassel, seek to avoid entering the domain of philosophy and psychology, will be found to proceed upon subjectivist *assumptions*.

The mathematical economist either forces all economic determinants into a homogeneous quantitative form (and therefore subjective), or dismisses those which cannot be so treated. He then posits certain "unknowns," and proceeds to set up a number of "equations." These equations if true, are always mere truisms, and consequently their solution is not causally significant. The "equation of exchange" and the "quantity theory" of the value of money are typical.

Among the mathematical economists we may distinguish (*a*) those who are more scientific, in that they seek laws of causation, and therefore seek to avoid question-begging assumptions. They go deeper than a mere mathematico-accounting technique. Gossen and Jevons illustrate these. They are more philosophical, and more aware of the problem of balancing costs and utilities. These are to be distinguished from (*b*) the more purely mathematical economists who merely reason in circles with the aid of symbols and truistic equations, such as Walras, Cassel, and Fisher (in part of his work). These men have an affinity for the narrow exchange-value economics which has been discussed in an earlier chapter.

(2) The non-mathematical subjective economists, or the

"psychological school," as they are sometimes called,[1] do not resort to differential calculus, and they use mathematics, if at all, for illustrative purposes. While they are similarly abstract and deductive, they confront the problem of causation more directly and frankly. They at least undertake to deal with the psychological difficulties involved in subjectivism. Thus they do not entirely lose sight of the fact that economics must deal with the human person and his behavior. These include the bulk of the Austrian School, led by Menger, Wieser, and Böhm-Bawerk, and such men as J. B. Clark and F. A. Fetter. (As already noted, Jevons and perhaps Gossen were equally "scientific" but were affected by that particular kind of abstraction which attends the Mathematical School.)

The second line of cleavage referred to above, concerns cost. While not clear-cut, this is the basis of important differences among subjectivists. (*a*) "Cost" may be regarded as "disutility" or "pain cost," and be treated as subjectively as utility, and coördinate therewith. This Gossen, at least, tended to do. Such an approach would make value result from a balancing of cost and utility. (*b*) Or cost may be regarded as secondary, subordinate, and dependent, as compared with utility. For example, the Austrian School subordinate cost by treating it as a foregoing of utility, or as "sanctioned" by value. (*c*) Finally, cost may be completely ignored, and be eliminated from the "equation," as the purely Mathematical School does.

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[1] This term is unfortunate, as it seems to imply some particular theory of psychology, although these economists, if they have any definite theory of psychology, differ widely. "Costs" may also be "psychological." What the term indicates is a common emphasis of the subjective.

a. Earlier Developments in the Marginal-Utility Concept

CHAPTER XXX

GOSSEN, JEVONS, WALRAS, AND THE MATHEMATICAL SCHOOL

The development of the marginal-utility analysis in value theory is commonly associated with the names of Jevons and of the members of the Austrian School. But, both in the concept of the margin and in the emphasis of utility and demand, these men were anticipated. As is usually the case, there were forerunners.

First Developments. — Not to dwell upon such suggestions as may be found in the writings of Galiani, Barbon, and others,[1] the French writer, Condillac, must be especially mentioned both because of his clear statement and his considerable influence. Condillac stated that value depends upon wants, being less in the thing itself than in the estimate we form of it. "A thing does not have value because of its cost, as some suppose; but it costs because it has a value." The true value of goods varies according to the intensity of wants and the supply of goods:[2] assuming equal utility, it varies according to our estimates of *rareté* or abundance.

Jeremy Bentham, famous in English jurisprudence and political philosophy, suggested the idea when he wrote: "The greater the quantity of the matter of property a man is already in possession of, the less is the quantity of happiness he receives by the addition of another quantity of the matter of property, to a given amount." [1]

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[1] Turgot, Genovesi, Bernouilli.

[2] *Le commerce et le gouvernement considérés relativement l'un à l'autre*, Paris, 1776. See p. 11 of ed. of 1803. "Now since the value of things is founded upon the want, it is natural that a more keenly felt want gives to things a greater value. . . . The value of things increases with scarcity and decreases with abundance. In abundance it could even decrease to nil. A superabundant good, for example, will be without value whenever one cannot make use of it, since then it will be quite useless."

Also noteworthy in this connection are the English writers Craig, Longfield, and Lloyd. John Craig in 1821 developed the significance of utility in value determination in an original way, analyzing the utility of a good into different strata which come into play as supply is increased.[2] But Longfield (1833) had a clearer expression of the marginal idea as applied both to utility and cost: to him market price was "measured by that demand, which being of the least intensity yet leads to actual purchases." [3] In the following year, W. F. Lloyd published a most remarkable *Lecture on the Notion of Value.* Value, he reasoned, may be defined as the esteem in which an object is held. Although human wants are varied and no limit can be assigned to their development, yet, for any specific object, an increase in supply will bring satiety and value will vanish (p. 10). Lloyd says: "In its ultimate sense, value undoubtedly signifies a feeling of mind which shows itself always at the margin of separation between satisfied and unsatisfied wants." [4] The claim of this Englishman to the distinction of first clearly explaining value in terms of marginal utility seems strong.[5]

At about the same time, a Frenchman, Auguste Walras, in studying the basis of property rights, reached the conclusion that value arises from the *rareté* (relative scarcity) of objects which have utility.[1] He argued that value is the relation between the quantity of a good and the sum of the effective needs for it, in other words, its *rareté*. He failed, however, to develop the idea of degrees of utility and the marginal analysis. It is of interest to note that a countryman, Augustin Cournot, soon published a work [2] which, while not developing the idea of marginal utility, did bring out clearly the relation between incremental variations in quantity of goods and those in prices. Cournot's work would thus tend to supplement that of A. Walras, and in any event was pioneering in the field of mathematical economics and marginism.

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[1] *Works*, IX, 18 (Edinburgh, 1843). See above, p. 248

[2] *Remarks on Political Economy*, p. 4. ". . . if more is now to be disposed of, it must be to those who did not reckon its utility equivalent to its former costs. New purchasers indeed will appear in proportion to the reduction of price; because at every step of the decline it is brought down to the estimate which an additional number of persons had formed of its power of producing gratification, or, in other words, to their estimate of its value in use."

[3] *Lectures on Political Economy*, p. 113. On Longfield see Cannan, *History of Theories of Production and Distribution*, and Seligman, *Some Neglected British Economists.*

[4] Pp. 12–16. Lloyd takes a now familiar illustration in the shape of a hungry man and successive ounces of bread, and clearly distinguishes "abstract" (total) utility from "special" (marginal) utility. He compares diminishing utility to the decreased pressure of a spiral spring as it uncoils!

[5] Lloyd appears to have been "discovered" in recent times by Professor T. S. Adams. See his article on "Index Numbers" in the *Journal of Political Economy*, December, 1901, p. 19.

The German, Thomas, has often been overlooked in this connection. In his *Theorie des Verkehrs* (1841), however, he very clearly states the main idea of the modern subjective theories of value: Value depends on estimation, and for estimation there must be not only an object, but a subject who evaluates. Value depends upon the strength of desire, and price upon a comparison of the estimations put by the parties to an exchange upon their goods. He expresses the idea of a scale with upper and lower limits (*Grenzen*).[3] Thomas, however, seems not to have thought it necessary to enter into the minute psychological analysis characteristic of the modern marginal-utility thinkers.

Similar ideas were soon advanced quite independently by a French engineer named Dupuit.[4] He wrote that "goods have a utility not only for each consumer, but also for each want for the satisfaction of which they are employed"; and seems to have clearly grasped the concept of final or marginal utility.

Finally, Senior should also be mentioned as a forerunner; and

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[1] *De la nature de la richesse et de l'origine de la valeur*, Paris, 1831.

[2] *Recherches sur les principes mathématiques de la theorie des richesses*, 1838.

[3] *Theories des Verkehrs*, pp. 16, 25, 66.

[4] *De la mesure de l'utilité des travaux publics*, 1844; *De l'influence des péages sur l'utilité des voies de communication*, 1849; "Utilité," *Jr. d'econ.*, July, 1853.

Banfield and Jennings, to whom Jevons himself expressed indebtedness, should not be forgotten.

The first writer, however, who *developed* the ideas now under consideration, and centered a more or less comprehensive system of economic theory in them, was Gossen.

Gossen. — Hermann Heinrich Gossen (1810–1858) was one of those unfortunate geniuses whose work fell upon deaf ears and unseeing eyes. Yet, although his book was all but forgotten and unknown, so clear and important was his contribution to economic theory that a few pages should be devoted to him.

Gossen's book, *Die Entwickelung der Gesetze des menschlichen Verkehrs* (Development of the Laws of Exchange among Men) was published in 1854 at Brunswick. The author states that it is the result of twenty years of meditation; that what Copernicus had done in founding the physical laws of the universe, that he, Gossen, had done for human society, — though some metaphysical Kepler or Newton might be needed to fill in the outline and determine the precise application of his forces. The confusion which existed in economic doctrine, he conceived to lie in the absence of mathematical treatment: to deal scientifically with complicated forces requires mathematics. He even suggested that while it is not now possible to measure absolute quantities of satisfaction, comparisons may be made by geometrical principles, and measurements of unknown quantities arrived at, just as distances are computed in astronomy. It may be said that his book is an attempt to put economics on an exact, mathematical basis.

The philosophy is essentially utilitarian and hedonistic. But the broad goal of a greater sum total of human happiness is constantly kept in view.

Gossen at once proceeds to develop a law of decrease in amount of satisfaction, using the common geometrical figures with their ordinates, abscissæ, and curves. From this law he derives the following principles: —

(1) "There is a manner of enjoying each satisfaction, chiefly

dependent upon the frequency, according to which the sum of the man's satisfaction reaches a maximum. If this maximum is reached, the sum of the satisfaction will be decreased by a more frequent, as well as by a less frequent, repetition."

(2) "The man who has the choice of several satisfactions, but whose time is not sufficient to procure all completely, in order to attain the maximum of satisfaction must — however the absolute amounts of the satisfactions may differ — partly enjoy all, even before he has completely enjoyed the greatest one; and this [must be] in such proportions that at the moment his consumption ceases the amount of each satisfaction is the same."

(3) The possibility of increasing the sum of the satisfactions of life, even under present conditions, exists when a new satisfaction, be it in itself ever so small, is discovered, or when one already known is extended.[1]

According to Gossen, things have value in proportion as they yield satisfactions or enjoyments. On this basis, commodities may be divided into three classes: first, those which have all the properties for yielding satisfactions, that is, consumers' goods, or *Genussmittel*, as he calls them. Next come "goods of the second class," comprising those in which the union of all the properties for complete enjoyment is lacking, as, for example, pipes and ovens and other complementary goods. Finally, production goods are distinguished. These embrace land, machinery, etc., and have an indirect value due to their ability to produce goods of the other classes. (He develops a theory of imputation.)

"With increase in quantity, the value of each added unit (*Atom*) must undergo a continuous decrease until it sinks to nil."[2] Thus, goods which yield only one satisfaction have their consumption limited by time, or the number of units consumed. As to a complex of goods: "If his powers are not sufficient to produce all possible means of satisfaction, man must produce each one to such an extent that the last unit of each has equal value to him." [1]

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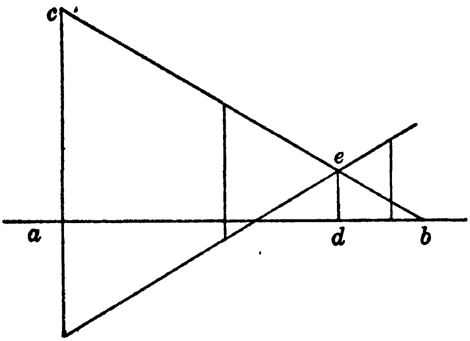
[1] *Gesetze des menschlichen Verkehrs*, p. 21.

[2] *Ibid.*, p. 31.

But, meanwhile, what of costs? Gossen here states that different goods require different degrees of exertion for their production, "and the value of the things produced thereby will naturally be diminished in the same degree with the estimation of the difficulty, as such." [2] He draws a diagram like the accompanying figure, and concludes that "the value reaches a maximum when the quantity *ad* is produced, i.e., when the production is carried on so long that the difficulty and the value are equal." [3] It follows that in order to obtain a maximum of satisfaction, men have to divide their time and energy spent in procuring different satisfactions, so that the last unit of any one satisfaction is equal to the amount of difficulty or disutility which would be caused if that unit were produced in the last moment of exertion, i.e., at the margin of disutility.[4]



Nor does Gossen let wants or desires go without some analysis along the line of difference in elasticity, etc. He distinguishes "needs" (*Bedürfnisse*) from luxury or pleasure desires, the former being those which cannot be trenched upon without bringing economy in other satisfactions; [5] and he notes some of the results which flow from the fact that men differ in their purchasing power.

The conclusion is that this obscure German anticipated much of recent development in economic theory. The subjective side of value, wants, is emphasized; the marginal utility idea of value determination is formulated; and this is brought into correlation with the margin of disutility. And his classification of goods into different orders or classes is suggestive of Menger's thought. All this he did, to say nothing concerning his development of mathematical methods of presentation. Perhaps the lack of elegance and clarity in exposition may account for a part of the neglect accorded him. The chief general criticisms seem to be his lack of system in presentation, and a failure to deal adequately with market price.

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[1] *Ibid.*, p. 33.

[2] *Ibid.*, p. 38.

[3] *Ibid.*, p. 39.

[4] *Ibid.*, p. 45.

[5] *Ibid.*, pp. 135 ff.

Jevons.[1] — Some seventeen years after the appearance of Gossen's book, yet quite independently, the English economist, Jevons, worked out similar ideas, and along similar lines. In an introduction to a collection of his essays another English economist, and one whose opinion has no small weight, says: "But I do not think it too much to say that the future historian of the science . . . will trace the main sources of its advance in the writings of four men, each of marked genius — Petty, Cantillon, Ricardo, and Jevons; and of these four, the name of Jevons . . . will not, I think, rank last in order of fame."[2] Though the words, "main sources," make the statement an exaggeration, it has its element of truth.

William Stanley Jevons was born in Liverpool, England, in the year 1835. He was a shy and thoughtful man, much given to introspection, and possessed of a very inquiring turn of mind. He attended University College School and University College, London, and in 1854 was made assayer of the mint at Sydney in Australia. Returning, he became successively lecturer and professor at Owens College, and professor at University College (1876–1880). His untimely death in 1882 came by drowning, and men have always regarded it as a great loss to economic thought.

Jevons brought into the development of English economic thought more of the spirit and discipline of pure science than any predecessor. He was no "moral philosopher" or retired business man or busy lawyer or social reformer. He was a social scientist who specialized in economic phenomena for the sake of ascertaining the laws which govern them. He was frankly a theorist. He sought the truth concerning fundamental principles, no matter where it might lead; and in his quest, he used the methods and technique which characterize the scientist in any field, and which are apt to be most highly developed in academic life.

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[1] See Wicksteed, P. H., *Common Sense of Pol. Econ.* II, pp. 734–754.

[2] Foxwell, introduction to Jevons' *Investigations in Currency and Finance.*

Though he wrote several books and numerous essays,[1] his *Theory of Political Economy*, published in 1871, will be mainly considered here.

Jevons' political economy, while treating of the wealth of nations with the purpose of teaching how the poor can be made as few as possible and all be well paid for their work, inquires how wealth may be best consumed. Consumption he gives a distinct place, and puts it before production and distribution,[2] in this departing from the practice of Mill and the Classical economists in general.

Thus wants, and their satisfaction by utilities, are emphasized. "The most important law in the whole of political economy" is the "law of variety" in human wants: each separate want is soon satisfied, yet there is no end to wants. (Note the idea of indefinite expansibility!) Banfield is quoted with approval as saying: "The satisfaction of every lower want in the scale creates a desire of a higher character." A "law of succession of wants" is also suggested, and is roughly illustrated by a range of utilities shading from air down through food, clothing, and lodging to amusements.

Jevons employs the word, "utility," "to denote the abstract quality whereby an object serves our purposes." He does not allow moral considerations to enter; mere pleasure and pain are the ultimate objects of the calculus of political economy.

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[1] *The Coal Question* (1865).
Theory of Political Economy (1871).
Money and Mechanism of Exchange (1875).
The State in Relation to Labor (1882).
Methods of Social Reform. }
Investigations in Currency and Finance. } Posthumous.
Logic. }

[2] See *Primer of Political Economy.*

He goes on to point out that utility is not inherent.[1] It is relative to wants, and too much of a good brings disutility. Utility decreases as the quantity increases. There is thus a difference between total utility and degree of utility, the degree of utility of successive units decreasing while total utility increases.

"There is a certain sense of esteem, of desirableness, which we may have with regard to a thing apart from any distinct consciousness of the ratio in which it would exchange for other things. I may suggest that this distinct feeling of value is probably identical with the final degree of utility. While Adam Smith's often quoted *value in use* is the total utility of a commodity to us, the *value in exchange* is defined by the *terminal utility*, the remaining desire which we or others have for possessing more." [2]

This final degree of utility is the degree of utility of the last or the next possible addition to a stock. It is the now famous term with which Jevons designated what we ordinarily call marginal utility. By it, exchange value is determined: "The ratio of exchange of any two commodities will be the reciprocal of the ratio of the final degree of utility of the quantities of commodity available after the exchange is completed." In fact, "The final degree of utility is that function upon which the whole Theory of Economy will be found to turn." [3] To illustrate, take water. Water has no value, for we have so much of it that its "final utility" is 0. But let the supply run short through drought, and we begin to feel a higher degree of utility, — and value comes into being.

Like Gossen, Jevons concluded that in consumption the tendency is to equalize final, or marginal, utilities.

He makes some further analyses: such as the distinction between actual, prospective, and potential utility; and the indication of three dimensions in utility — quantity, degree, and duration. He points out that the time element, too, must be allowed for, as an element of uncertainty. In this connection he undertakes to apply the idea of final degree of utility not only to current choices, but also to future choices — to the process of discounting the future use of goods. He emphasizes the fact that in appraising goods now, men consider not only the duration of the period during which they will be consumed, but also the degree of certainty that consumption will be possible.

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[1] *Theory of Political Economy*, Chap. III.

[2] *Ibid.*, p. 157.

[3] *Ibid.*, p. 61.

In developing his ideas Jevons endeavored to work out a theory of objective exchange value by applying mathematics. He argued that we do not need to employ units of measurement for quantities of feeling, because the individual makes direct comparisons in his mind. He does not assume that we can measure the utility of the last unit of a good, as a quantity of pleasure. He would deal only with relations — the *ratio* of final degrees of utility. His concept is of a ratio between (1) the changes in utility of a good and (2) the changes in the number of units of the good. He would thus avoid the assumption of an exact quantity of pleasure at the margin, and at the same time would provide a homogeneous basis for comparing the relative importance of all sorts of goods. This is an outstanding point in his theory.

In this way, Jevons deals with the difficulty that every mind is inscrutable to every other mind, and consequently no common denominator is to be found. This difficulty he endeavors to escape by turning to the "aggregate" of individuals, arguing that "the laws which we are about to trace out are to be conceived as theoretically true of the individual; they can only be practically verified as regards the aggregate transactions, productions, and consumptions of a large body of people. But the laws of the aggregate depend of course upon the laws applying to individual cases." [1]

He then works out his formula, based upon the ratio of final degrees of utility, for explaining the determination of exchange values, — with which values, regarded as mere "ratios of exchange" Jevons was primarily concerned. It is as follows:

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[1] P. 52. Note the individualistic point of view implied.

$$\frac{\phi_1(a-x)}{\psi_1 y} = \frac{y}{x} = \frac{\phi_2 x}{\psi_2(b-y)}$$

This may be "translated," as follows:

$$\frac{\left(\begin{array}{l}\text{marg. utility}\\ \text{of corn to } A\end{array}\right) \times \left(\begin{array}{l}\text{quantity available}\\ \text{after exchange}\end{array}\right)}{\left(\begin{array}{l}\text{marg. utility}\\ \text{of beef to } A\end{array}\right) \times \left(\begin{array}{l}\text{quantity of}\\ \text{beef exchanged}\end{array}\right)} = \frac{\begin{array}{l}\text{quantity of}\\ \text{beef exchanged}\end{array}}{\begin{array}{l}\text{quantity of}\\ \text{corn exchanged}\end{array}}$$

$$= \frac{\left(\begin{array}{l}\text{marg. utility}\\ \text{of corn to } B\end{array}\right) \times \left(\begin{array}{l}\text{corn}\\ \text{exchanged}\end{array}\right)}{\left(\begin{array}{l}\text{marg. utility}\\ \text{of beef to } B\end{array}\right) \times \left(\begin{array}{l}\text{quantity available}\\ \text{after exchange}\end{array}\right)}$$

Jevons says that the only unknowns in this equation are x and y, i.e., the quantities of the two commodities exchanged.

Quite naturally Jevons attacked the labor-cost theory of value, and, for that matter, all cost theories. His brief runs something as follows. In the first place, many valuable things are not reproducible at any cost; hence all such goods are not subject to a cost-explained valuation, and a cost theory is at best partial. Again, the facts show that market values *generally* fluctuate either above or below cost, seldom equaling it. Finally, there seems to be little relation between the quantity of labor expended and the ultimate value of the product. Take the Great Eastern steamship, for example. In spite of its cost, what is its value when it is found impracticable to use it? In short, "labor once spent has no influence on the future value of any article:"[1] its value on the contrary rises and falls according to the degree of its utility.

The obvious reply to Jevons is that this degree of utility depends partly upon supply, which in its turn is subject to limitations of cost. Indeed, Jevons himself goes on to admit that labor plays a part as a determining circumstance, reasoning that labor affects supply, supply affects degree of utility, value depends on degree of utility. This appears to be virtually an admission that the case for utility is overdrawn.

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[1] *Theory of Pol. Econ.*, p. 159.

Jevons has been further criticized in two matters of importance: first, he confuses demand price — what marginal purchasers will pay — with marginal utility, apparently assuming that the relations of the two to value are the same;[1] and, in the second place, he is guilty at points of substituting the idea of social utility for that of individual utility, leaping the gulf which lies between the utility scales of different men.[2]

In his theoretical writings, Jevons' method was deductive and mathematical, and, indeed, his conception of political economy was not dissimilar to that held by Senior, whom he cites with approval. He believed, as Gossen had believed, that economics can and should be a science, and that the mathematical method is necessary to make it so, — a necessity inherent in the measurement of pleasures and pains.[3]

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[1] See, e.g., Marshall, *Principles*, Bk. V, Chap. XIV, note.

[2] See, e.g., *Theory of Pol. Econ.*, pp. 61, 96.

[3] Jevons' other economic theories may be briefly noted, as follows:

One of the notable services of Jevons was his work as a statistician. Here he showed marked ability, powers of analysis and imagination being happily combined. His countrymen, Petty and Malthus, had made use of statistics, but with inferior data and less natural acuteness. Jevons had that peculiar gift of detecting likenesses and differences — of discerning "Movements" — in masses of data, which is essential to the statistician. His chief work was in the field of prices. Here he detected monthly movements, yearly movements, — in the autumn, — periodic movements due to crises, and longer cycles resulting from changes in the value of money. His famous hypothesis concerning the relation between industrial depressions, and the periodic recurrence of sun spots will be familiar to most.

It is to be regretted that so acute an observer should have failed to show the deepest insight in dealing with the labor problem. Starting from the premise that the wages of workmen are "the value of the goods produced, after the necessary rent of land and interest of capital have been paid" (*Primer*, p. 64), he concluded that strikes are folly, that to decrease hours would result in decreased wages, and that the objections of trade unions to piece work wages are absurd, — "for men must generally be supposed capable of taking care of their own health." It is but to be remarked that a preponderance of the best economic thought would not accept these conclusions without essential qualifications.

Though his labor doctrine smacks somewhat of *laisser faire*, it is one of Jevons' merits to have thrown light upon the relation of state to industry. In his *State in Relation to Labour* he shows that, while the presumption is perhaps in favor of

Walras. — Léon Walras (1834–1910) is another economist who was slow in gaining recognition, and whose fame has suffered from no fault of his work, but from causes exterior to it. His *Élements d'économie politique pure* (Elements of Pure Economics) was published in 1874, thus shortly following the works of Jevons and Menger.[1] His thought was undoubtedly independent, however, and he himself recommends Jevons' book as complementary to his own. He constructed a more complete system based upon mathematical analysis than did Jevons. The establishment of the Mathematical School may be dated from Walras, for, though he was preceded by Cournot, his work was much more complete and systematic.

To some extent, like Senior, Gossen, and Jevons, Walras sought to make economics an abstract science, distinguishing pure economics from applied economics, on the one hand, and from social economics on the other. Truth, he held, rather than the useful or the good, should be the goal. In his opinion, economists had given too much attention to exceptional cases, such as old masters' pictures.

His great object was to expound a mathematical theory of exchange, and it is on the second part of his book, entitled "Mathematical Theory of Exchange" that interest is to be chiefly centered. To achieve his end, he assumes a perfect competition such as might obtain in the Bourse, and, like Say, makes the entrepreneur, receiving and distributing payments for "productive services," the center of the scheme. He neglects the action of impulses, and, after the fashion of the hedonist, employs the general hypothesis of exchanges between parties who seek in exchanging to secure the greatest possible satisfaction of their desires.

Social wealth, as defined by him, consists of all things, material and immaterial, which have utility and are limited in quan-

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individual freedom, yet happiness must be the ultimate test. The state may properly interfere when: (1) best coördination of numerous scattered operations requires; (2) processes involved are routine; (3) work is under the public eye; (4) little capital is involved.

[1] Other works (posthumous): — *Études d'économie sociale* (1896) and *Études d'économie politique appliquée* (1898); revised ed., Paris, 1936.

tity. The amount of the value of external things is proportional to the amount of satisfactions they bring us. There is no direct or immediate relation between supply and price; but such a relation does exist between price and demand, and the demand curve depends upon this relation. The cause is intensity of utility. And where two commodities are concerned the demand curve depends upon the relation between the intensity of utility of the one commodity and that of the other. The price, then, where neither of the commodities entering the exchange is valueless, is such that the intensity of the last want satisfied is the same for each.

For Jevons' "final degree of utility" — and Gossen's *Werth der lezten Atome* — Walras uses the *rareté*, which he defines as "the intensity of the last want satisfied."[1] Exchange values are proportional to *raretés*. Two commodities being given, for instance, if the utility and the quantity of one of the two commodities in respect to one or more exchangers varies, so that the *rareté* varies, the value of that commodity in relation to the other, or its price, will likewise vary.

In some respects Walras' *rareté* appears to be a truer concept than the common notion of marginal utility; for, in defining it as depending on supply and utility,[2] he gives clear recognition to the fact that supply limitations are included and expressed in it. It would not be difficult for both cost and utility theorists to approach some agreement with Walras' formula, according to which utility and supply, working in obedience to the theory of maximum satisfaction, determine the demand curve from which, positing the law of a single price for the market, comes price.[3]

It is to be emphasized, however, that *rareté* is subjective. Like his fellows of the mathematical-utility school, Walras' theory is based upon the assumption of a direct relation between demand and price and the absence of such a relation between supply and price.

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[1] *Économie politique pure*, p. 101.

[2] Walras expresses indebtedness to his father, Auguste Walras, who used the word *rareté*, and defined it similarly. See *De la nature de la richesse et de l'origine de la valeur*, Paris, 1831. M. Walras, senior, did not work his ideas out with breadth or clearness, however.

[3] *Écon. pol. pure*, p. 99.

In contrast with Gossen, Walras treats with notable clearness the subject of market values; and he goes beyond Jevons in formulating his exchange equations for dealings in any number of commodities rather than two alone.[1]

Nevertheless one puts down the "pure political economy" with the feeling that little if anything has been added to real knowledge. What boots it that "the effective demand or supply of one good in terms of another is equal to the effective supply or demand of the other multiplied by its price in terms of the first good"? Other economists had stated that demand equals supply!

Instead of seeking causes, he sets up a number of simultaneous equations equal to the number of the "unknown" (prices), and proceeds to turn the crank. Starting from the obvious and question-begging equation, "demand for *a* × value of *a* = supply of *b* × value of *b*," Walras draws curves whose axes are (1) quantity of a given good demanded at a given price, and (2) prices of the given good in terms of another good: his curve "gives the quantity of *a* effectively demanded, as functions of the price of *a*." Finally comes the italicized statement: "Two goods being given, in order that there be equilibrium, or a stationary price of one in terms of the other, it is necessary and sufficient that the effective demand of each of the two goods be equal to its effective supply (*offre*). When that equality does not exist, in order to reach an equilibrium price there is necessary a rise in the price of the good of which the effective demand is greater than the effective supply, and a fall in the price of the one whose effective supply is greater than the effective demand." He uses a formula which is practically identical with that shown on a preceding page in the discussion of Jevons.

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[1] For a brief statement in English of Walras' mathematical theory of the determination of prices, see *Ann. Amer. Acad.* III, 45–64 x (1892). Walras' problem is to represent the determination of prices of commodities in general — all commodities — while recognizing that these prices are interdependent. The idea is that with the aid of a number of equations equal to the number of "unknowns" a theoretically soluble problem exists. Aside from the question of causation, however, there is the fact that in reality the data are not available.

Cassel. — From Léon Walras, we jump ahead to Gustav Cassel,[1] the Swedish engineer turned economist, who has developed Walras' theory, and applied it more broadly to distribution and money. It is true that Cassel aims to eliminate the old theories of value, and rejects the theory of marginal utility as a solution of the problem of value. But he really puts nothing in their place, his thought being so to limit the scope of economics as to avoid the problems of causation. If he were to go into the matter, he would doubtless be driven to some similar form of subjective marginism. He adopts an abstract mathematical procedure, assumes the existence of value and prices, and constructs demand and supply schedules consisting of quantities which depend upon price. His theory is at bottom essentially the same as that of Walras or Jevons. He resorts to an idea of scarcity similar to Walras' *rareté*.

In fact, Cassel's rejection of marginal utility seems to be a frank attempt to limit economics to an empirical dealing with exchange ratios among objective quantities, merely taking utility and subjective value for granted. He seeks to explain economic phenomena by the single principle of "scarcity." In doing this, he assumes and takes for granted (1) limited supply and unlimited wants, (2) the necessity of exchange, and (3) the function of price in balancing supply and demand. He accepts observed movements in price in lieu of a theory of value causation.

In developing his theory, Cassel adopts the device of first assuming "simple" cases, and then introducing the complications. (1) He begins by assuming that supply is a fixed and known quantity of goods, and argues that, when the prices of all goods are fixed (by using a set of simultaneous equations), the demands of consumers can be known.[2] Demand is made a function of price or prices, and is expressed in quantities of goods. (2) He next assumes that supply consists, not in a quantity of goods, but in a fixed quantity of the factors of production. The prices of the factors of production are then supposed to equal the prices of the goods into which they enter through production. (3) He then introduces money. The purchasing power of consumers is said to be derived from their participation in the processes of production; their incomes representing the total of prices paid for the use of the factors of production. (4) He then introduces a sort of quantitative dynamics by assuming that fixed and constant percentages of change occur in production activity, and the equations are again set up on that basis.

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[1] Cassel's theories are found in his paper on *Outline of an Elementary Theory of Prices* (1899), *Nature and Necessity of Interest* (1903), and *Theory of Social Economy* (1918) (English edition, 1923).

[2] *Theory of Social Economy*, p. 136.

Finally, Cassel states that his procedure gives us the relation among all prices, but not any single absolute price. If one such were known, all others could be absolutely determined. He proceeds, therefore, to expound the determination of the value of money, and more particularly the price of gold — presumably in an attempt to supply the missing absolute quantum.

His general theory of prices is more clearly worked out than Walras'. He develops a theory of money, and an analysis of monetary phenomena, which had much influence in the second and third decades of this century. But his system is too deficient in fundamental basis to endure. His thought is too abstract, and his logic too circular. It would be impossible to get all the data required for working out his equations; if we had the data, we could add nothing to our knowledge by solving them.

Such theory is viciously abstract in that it omits, not only institutional and social-control facts, but also the differences which exist in individual attitudes — differences between necessity and choice, or between impulsive and reflective action.

Like Walras, from whom he borrows, Cassel begs the whole question of economic life, value. By assuming value to start with, and thus evading the problem of its cause, he is estopped from dealing with its determination. The result is a system of business mathematics, not a social science.

Summary. — In brief summary of the character and importance of the thought of Gossen, Jevons, and L. Walras, it may be stated that all emphasized the subjective element in value causation, that all pursued a deductive, mathematical method, and that all arrived at a concept of the margin, where a final or most intense want is satisfied. Their philosophy is utilitarian and hedonistic. (With the exception of the emphasis of marginal utility, these observations apply also to Cassel.)

The mathematical approach is essential, especially in the thought of Cournot, Walras, and Cassel. (Much of Jevons' and most of Gossen's thought would stand up without mathematics. Without the equations, L. Walras does not seem to go beyond A. Walras, and Cassel not beyond L. Walras, in so far as any *positive* additions to value theory are concerned.) The mere mathematician needs measurable quantitative data, which are homogeneous, and are either fixed or vary in relation to one another. In dealing with values, this leads him to extremes of abstraction, and limits him to quantities exchanged. He more or less takes for granted and assumes the quality of value, and sets up "equations" which, if true, are truisms. In assuming the causation of value, he provides no basis for prediction, law, science.

Another notable point of likeness is that each of the three chief earlier economists discussed formulates more or less precisely some law concerning the attainment of maximum satisfaction. Walras puts it thus: "Taking two commodities on a single market, the maximum satisfaction of wants or the maximum of effective utility exists when and where the ratio of the intensities of the last wants satisfied, or the ratio of the *raretés*, is equal to price." [1]

One great difference between Jevons and Walras deserves attention, and that is the fact that Jevons has a better appreciation of the causation of values, and consequently goes more deeply than Walras into the real problem of determination. Walras, for example, frequently starts out by assuming his price, and his supply and his demand are price-determined quantities. Jevons seeks to build up to his price by proceeding from causal forces to determination. This difference undoubtedly proceeds from the fact that Jevons was more affected by the Classical English economics, which at bottom has a sort of social point of view, however much it may be shoved into the background. Walras is more mathematical and more inclined both to assume the existence of value and to think of it as a quality of goods, both material and immaterial; Jevons is more psychological — though not more subjective — and endeavors carefully to guard against treating value as lying in goods.

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[1] *Écon. pol. pure*, p. 86.

As to Cassel, in his extreme individualistic and mathematical technique he goes beyond Walras and even spurns causal analysis. His subjectivism, therefore, has to be assumed — just as he assumes the existence of the value quality.

As will appear from a reading of the next chapter, the analysis of subjective elements made by these men lacks the refinement to which it has been carried by the Austrian School. And, excepting Gossen, their emphasis on changes in quantity of goods and on exchange in markets tends toward the idea of value as a relation between commodities, which in the last analysis is hardly consistent with strict subjectivism.

b. Fully Developed Subjectivism: The Austrian School

CHAPTER XXXI

MENGER, WIESER, AND BÖHM-BAWERK, AND ESPECIALLY THE DEVELOPMENT OF SUBJECTIVE THEORIES OF VALUE AND INTEREST

Many of the earlier economists expressed a general recognition of the fact that utility is essential to value. Subjective factors, too, were more or less recognized. These economists were, however, inclined to take utility and the demand based upon it for granted. It was a matter of course with them. They were almost obsessed by the idea of an absolute standard of value in the shape of a quantity of labor-time, and thus considered value as objective. This is especially true of the leaders of English thought, less true of the Germans, and least so in the case of a French and Italian group in which Galiani, Genovesi, Turgot, Condillac, and Say may be placed.

As has been seen, Gossen, Jevons, and Walras developed this aspect; but Gossen remained almost unknown, while contemporary with Jevons there arose a school of Austrian economists who carried on this line of development with a broader application and a deeper analysis. The "Austrian School" so analyzed utility as to base a theory of the causation of economic values upon subjective elements. Their reasoning they applied to the valuation of the factors of production, with the result that they developed a notable theory of capital and interest. In these points they stand as critics of the Classical School.

The members of this school, for better or for worse, were deeply influenced by German economic literature, and that literature was rich in criticism of objective exchange value theories and in psychological analysis.

The Austrians and Their Value Theory. — Carl Menger laid the cornerstone for the Austrians with his *Grundsätze der Volkswirtschaftslehre*, 1871,[1] — the same year in which Jevons' *Theory* appeared. Menger felt that economic theory had fallen into disrepute with many scholars, and he sought to restore it to its place of honor by freeing it of inconsistency and basing it upon more fundamental laws of causation.

All things, he says, are subject to the law of cause and effect. In economics the human want is the fundamental thing. Things which have the capacity of being placed in causal connection with the satisfaction of human wants are utilities. To bring an object into the sphere of economic causation four conditions are necessary: (1) a human want, (2) such properties of the thing as make it capable of being placed in causal connection with the satisfaction of this want, (3) the recognition of this causal relationship by man, (4) the power to dispose of the thing so that it can actually be applied to the satisfaction of the want.[2] With such analysis Menger sought to arrive at ultimate causes, and to draw an explanation of value — which he regards as the heart of economic theory — from the economic activity of the individual, that is, from his exchange contracts. Although he gives some recognition to the influence of society, Menger considers value as an individual phenomenon: it is independent of society and the laws of the state. He defines value as "the significance which concrete goods or groups of goods gain for us through the fact that in the satisfaction of our wants we are conscious of a dependence upon the disposal of them." [3]

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[1] Other writings: — *Untersuchungen über die Methode der Sozialwissenschaft*, 1883; *Die Irrthümer des Historismus*, 1884; "Zur Theorie des Kapitals," 1888 (in *Jahrbücher für Nationalökonomie und Statistik*); "Gründzuge einer Klassifikation der Wirtschaftswissenschaften," 1889 (in *Jahrb. f. Nationalökonomie und Statistik*); "Beiträge zur Währungsfrage in Oesterreich-Ungarn," 1892; *Die Übergang zur Goldwährung*, 1892.

[2] *Grundsätze*, p. 3.

[3] *Ibid.*, p. 78.

In opposition to cost theories, he maintains that value rests on utility and relative scarcity.

Goods are divided into different classes, or "orders," according to their nearness to the consumer.[1] Thus bread is in the first order; flour in the second; wheat in the third. Goods of the last description are of the "higher order," and their value is reflected back from those of the "lower order": wheat has value because and in so far as men want wheat bread to maintain life and well-being.

Differences in value are due to the different estimations which men put upon the satisfaction of various wants. The value of a concrete good, or of a certain aggregate, at the disposal of an economic man is equal to the significance of the least important want satisfactions yielded.

Always, where there are the bases for an exchange between men *who are actuated by economic motives*, certain limits are set by the quantities of exchangeable goods which are deemed equivalents by the parties; and these quantities, which in a subjective sense are equivalents, differ with different individuals. Within these limits price is determined. If A estimates 100 units of grain at 40 units of wine, and B estimates 80 units of grain at 40 of wine, an exchange can take place, the price in grain lying somewhere between 80 and 100.[2]

Over and over again Menger repeats his statement that value and the measure of value are subjective and dependent on wants. The quantity of labor or capital expenditure involved has no direct or necessary connection.[3] In a primeval forest one may chop wood till doomsday without making that wood valuable, while a diamond picked up by chance has great value. Nor does the cost of reproduction solve the matter;[4] for there are many goods which cannot be reproduced, and many others, like out-of-date clothes, whose value is less than that of the agents of their production. Menger pays virtually no attention to objective values, and does not attempt to deal with costs in a definite way.

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[1] Chap. I, § 2.

[2] *Grundsätze*, p. 176.

[3] P. 120.

[4] Cf. above, pp. 320, 323.

The next important step in the development of the Austrian theory comes with the publication in 1884 of the *Ursprung und Haupt-Gesetze des wirtschaftlichen Werthes* (Source and Principal Laws of Economic Value) by Friedrich Freiherrn von Wieser. He built upon Menger, applying his theory to the phenomena of costs and distribution, and deepening the psychological analysis. In his later thought, he worked out a theory of objective value, though not independently.

Wieser's complicated statement of what gives economic value to a good may be translated thus: (1) If things are capable of producing useful effects (aside from things of indifference, and perhaps those which are harmful); (2) if their supply does not equal the employment for them; (3) if they allow encroachments by men which, when economic, increase their usefulness, and, when uneconomic, decrease it; (4) if all subjective suppositions which complete these objective ones agree; (5) and if, then, the existence of the good, its utility, and other external circumstances are perceived; (6) if the need for it is not only distinct, but also its satisfaction is desired; (7) and if the purpose is formed to do the economic acts which show themselves practicable while shunning the temptation to uneconomic action, — then will the interest be transferred from the expected economic uses to the goods, and become associated with them, i.e., then the goods receive economic value.

"The value of a single good out of a store is determined by the interest in that useful service which is the least important among the most important ones afforded by the store." For Jevons' "final utility," he substitutes the term, *Grenznutzen* (marginal utility), which has since become so generally used.[1] In his *Natural Value*, Wieser expresses himself more boldly; saying, "In a word, the value of a supply of similar goods is equal to the sum of the items multiplied by the marginal utility."[1] This, of course, implies a divisible good with more than one unit of supply; and Wieser states that the law rests upon the existence of scales of want and the "fact that goods come forward in stocks or supplies consisting of similar items."

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[1] It will be remembered that von Thünen developed a marginal productivity theory, and he used the word *Grenze* (margin) in connection with it. See above, pp. 368 f.

In explaining the value of the factors of production, Menger had held that the decisive thing is the portion of the return which would be lost through the removal of any production good ("goods of a higher order"). (This involves a theory of *negative imputation.*) To this theory, Wieser objects. In his *Natural Value* (1889) he bases such value upon the "productive contribution" of the factor — a theory of *positive imputation.* He uses the principle of complementary goods, and argues that "the elements that are bound up . . . may alter, and this fact makes it possible for us to distinguish the specific effect of each single element,"[2] by comparing a number of equations.

This theory Wieser reaffirms in his last work on *Theory of Social Economics* (1914). He draws a distinction between "cost instruments of production," which are reproducible and applicable to more than one use, and "specific instruments of production," which, like land, are naturally scarce or limited to a single use. Cost instruments, being subject to many uses, can have their productivity imputed by comparing numerous equations; but specific instruments must be treated as residual claimants, being assigned such portions of the marginal utility of the joint product as are not imputed to the cost instruments with which they are used (labor and capital). This is merely a broadened rent concept, such as has been adopted by not a few other economists.

It would seem that even if Wieser's scheme be useful in an illustrative way, and as a practical means of *measuring* the value of production goods in any given amounts, it is lacking — as is Menger's — when it comes to the more fundamental problem of *determining* their value: It does not explain causes or points of fixation. Economists are, to say the least, sceptical of the possibility of specifically attributing a separate portion of a joint product, — one for whose existence each of several coöperating factors is necessary, — to any one of the factors taken alone, and especially so on a mere marginal utility basis.

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[1] Eng. ed., p. 25.

[2] P. 87.

Meanwhile, what becomes of the idea that it is the cost of these elements of production that determines the value of the product? This Wieser denies, though admitting that costs have an indirect and partial effectiveness. It is his idea that only men's interests, based on utility, induce them to estimate value at cost. *This development of the conception of cost as subjected to utility is one of his chief contributions to the theories of the Austrian School.*

To use his own words: —

"If we ask why products thus produced — neither under nor over costs — have value, and why they have definite amounts of value, we shall doubtless find that they have themselves alone to thank for it. They create it out of their utility, taking into consideration the amounts produced. The circumstance that costs of a certain value have been expended in making them is of no consequence as regards their value. The cost value does not determine the use value; *the use value exists of itself, and sanctions the cost value.*" [1]

Cost is "sanctioned" by use-value, — is, in fact, nothing but a complicated form of value in use.

But, as just intimated, costs are admitted to "affect" values. Though not consistently followed, the idea appears to be that the anticipation of value (utility?) gives costs themselves a *value*. Then the "value of costs" [2] may even determine value of goods, either indirectly, by regulating supply, or directly, in individual cases, by communicating their own value to the good. "The Austrian School does not in any way destroy the idea of cost or the law of cost, it only endeavors to combine both with the general idea of value and its general law, and to explain them in this way." [3]

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[1] *Natural Value* (Smart's ed.), p. 177. Italics supplied.

[2] *Ibid.*, p. 176.

[3] Wieser, "The Theory of Value" (A Reply to Professor McVane), *Ann. Amer. Acad.*, II, 620 (1892).

Wieser's explanation of the existence of the old notion concerning costs is ingenious and interesting. Just as the value of a mineral spring depends on the utility of its water, so iron, coal, and labor derive value from the utilities produced. But here, any one unit of commodity reflects so small a portion of its total utility that it seems that the process is reversed, and that the commodity derives its value from the elements entering into its production. The individual capitalist, for example, if his means of production have other applications, finds them evaluated in the general market, and he tends to regard the situation as one in which the value of his wares must replace his expenses of production. But, argues Wieser, the buyers of his wares pay only according to their estimation of the marginal utility. All that cost does is to limit the supply put upon the market.

"At the sale of the products the capitalists continually rectify their calculations, and according to their gains or losses the value of the means of production increases or diminishes in their estimation." Put more abstractly, when production is bringing forth products, productive powers are at the same time limited, making economy necessary. This leads men to conceive of production goods as costs, directing their attentions to the equalization of related productions, and causing them to regard productive employment as an outlay or sacrifice.[1]

In following the thought of the Austrians, we must constantly remember that by costs they generally mean mere "opportunity costs" based on alternative use, — an entrepreneur concept. As Wieser puts it: "Costs are production goods when these are devoted to one individual employment, and, on account of their capacity of being otherwise employed, take the shape of outlay expenditure." [2]

In examining the foregoing idea of costs in relation to value, one is struck with the juggling way in which now all that the properly limited Classical idea contains is admitted, now all is rejected. No one denies, or ever has denied, that "the idea of utility cannot possibly be separated from the purposes of economy and the conception of wealth"; [1] nor that, when costs are involved, men's interests based on utility lead them to estimate value at cost; nor that value is created out of utility, "*taking into consideration the amounts produced.*" But many deny that the fact that certain costs have been necessary is of no consequence in value, and it would seem that "the amount produced" can be *taken for granted* only by making assumptions concerning the cost of producing those amounts which beg the question at issue. The trouble seems to lie in a confusion of the ideas of (1) source or causation and (2) limits or determination. As in the case of the proverbial hen-*vs.*-egg conundrum, it is of small importance whether wants or costs come first as causes or sources of value. We may well grant that the want, with its corresponding utility, is the first of the fundamental forces to act. No one will deny that utility in a sense "sanctions" cost. But when we are taken further and told that costs have no *determining* importance, the harmony is broken. In cases in which supply is limited by costs, so that cost enters into the determination of the "margin," it is as important a factor as the utility which decreases as the supply is increased.

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[1] *Natural Value* (Smart's ed.), pp. 174–175.

[2] *Ibid.* For a criticism of the opportunity-cost idea see Haney, "Opportunity Cost," *Amer. Econ. Rev.*, Vol. II, p. 590.

To speak of "use-values" and "value of costs" is quite misleading. If "use-value" means any more than utility, cost or rarity has entered; just as costs can have no value unless utility is joined with them.

Wieser goes on to argue as follows: (1) Labor cost has "use-value" only (*a*) when, if once the labor ceased, it could not be repeated, and so the product would be unique, or (*b*) when, in the same case, some other utility would have to be foregone. (2) On the other hand, services are estimated according to cost only when, in the event of a cessation of production, one would not need to give up the utility, because an abundance of labor power exists. He concludes that this is a contradiction, saying, "Labour could be estimated both by its utility *and* by personal effort, only if it were both capable and incapable of repetition."

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[1] *Natural Value* (Smart's ed.), p. 196.

To this objection, it may be immediately replied that in a sense this seeming paradox is the very truth: the very point in the two-sided theory of value is the fact that while labor can be repeated, it can on the whole be repeated only with difficulty; that is, with cost, which fact limits its repetition. It may be further observed that in the first clause (1) of the argument just stated, the first assumption (*a*) involves a case of absolutely limited supply; while the second clause involves an abstract assumption which is contrary to fact.

Last of the three pillars of the Austrian School comes Eugen von Böhm-Bawerk (1851–1914). Böhm-Bawerk opened his important contributions in 1884 with his well-known *Capital and Interest*, a critical history of economic theory; following with a monograph, *Grundzüge der Theorie des wirtschaftlichen Güterwerths*[1] (Outlines of the Theory of Commodity Value) (1886), and his masterpiece, the *Positive Theory of Capital* (1888).[2]

Böhm-Bawerk is notable not only for independent thought, but for clear exposition and illustration, and a "careful and fruitful revision of many matters of detail." To some extent following the German economist, Neumann, he further elaborates the division of value into subjective and objective — with which he would replace the old division into use-value and exchange value, — and one of his distinct merits lies in his treatment of objective value or purchasing power. He it was who first among the Austrians gave us a well-rounded attempt to bridge the gap between the subjective and the objective, and to develop a complete theory of objective exchange value and price.

Subjective value is defined as the significance which a good acquires as the recognized condition of a use for well-being which would have to be foregone without the good. The amount of value depends upon the amount of gain in well-being which the good brings, or what want would remain unsatisfied without it: "The value of a good is determined according to the importance of the concrete want or increment of want, which is the least important of those met by the supply of such goods at disposal," — i.e., by its marginal utility.

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[1] Conrad's *Jahrbücher f. Nat. Oek.*, N.F., XIII.

[2] In the German, the first and last works constitute his *Kapital und Kapitalzins*, Innsbruck, 1884–1889. The English translation in separate volumes is by Smart.

Böhm-Bawerk distinguishes two sorts of subjective value: Subjective use-value — defined in the preceding paragraph, — and subjective exchange value. The latter, which he thinks differs much less from use-value than it does from objective value, is simply "the importance which a good obtains for the welfare of a person through its capacity to procure other goods," and its amount coincides with the use-value of the goods received in exchange. Commonly, use and exchange subjective values differ from one another, in which case the higher of the two sets the value.

But the word "value" does not always suggest the subjective.[1] Thus when we say that a pound of gold has a higher exchange value than a like weight of iron, we refer only to an objective relation between commodities. Exchange value in the objective sense, is nothing but the capacity of a good to command other goods in exchange. It is a social phenomenon, and could exist only in society. Böhm-Bawerk, however, attempts to show that it rests upon individual valuations. First, he takes an isolated pair; then, competition among a group of buyers is introduced; then competition among several sellers, — till finally two-sided competition is considered.[2] To cut a long story short, he concludes, with considerable amplification and refinement of his predecessors' teaching, that objective exchange value is determined somewhere between (1) an upper limit set by the valuations of the last, or least desirous, buyer included in the exchange and the most capable seller excluded, on the one hand, and (2) a lower limit established by the valuations of the least capable seller — the last seller — and the most desirous buyer excluded.[1] In every case, it is the narrower of these double limitations that decides. "If, finally, we substitute the short and significant name of 'Marginal Pairs' for the detailed description of the four parties whose competition determines the price, we get this very simple formula: The market price is limited and determined by the subjective valuations of the two Marginal Pairs."

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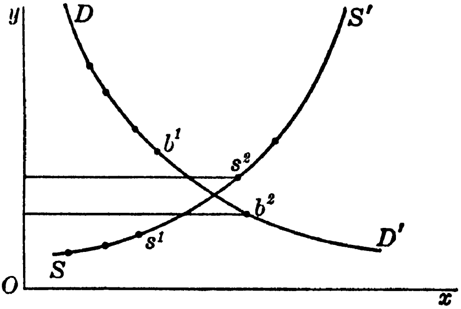
[1] "Grundzüge," Conrad's *Jahrbücher*, 1886, p. 477.

[2] *Ibid.*, pp. 492 ff.: *Positive Theory* (Smart's trans.), pp. 198 ff.

The clearest view of the foregoing scheme may be gained when it is illustrated by curves, though Böhm-Bawerk does not use diagrams. If *DD′* represents a series of buyers' subjective values arranged in descending order, and *SS′* a series of sellers' subjective values arranged in ascending order; and if b^1 and s^1 = the last included buyer and seller respectively; then the maximum price will be set by the pair b^1 and s^2, and the minimum by the pair s^1 and b^2. In the diagram s^2 and b^2 are closer together than b^1 and s^1; and consequently they set the limits.



The factors which determine the valuation level are: the number of desires for the ware, the height of the buyers' valuation figures, the quantity of the ware for sale, and the height of the sellers' valuation figures. But these valuation figures are no simple quantities; they are obtained by comparing valuations of the wares with the valuations of their "price goods." [2] This makes it necessary to introduce two further elements: the absolute quantum of the subjective value of the "price good," or the price equivalent to the would-be buyers; and the same quantum to the would-be sellers.

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[1] "Grundzüge," above cited, p. 208.

[2] *Ibid.*, p. 509. The Germans use the word "price" (*Preis*) not to signify the money expression of exchange value, but the amount of any good received in exchange for that sold.

Böhm-Bawerk, like Wieser, admits that cost plays a part in determining value, but a subordinate and indirect one.[1] In the case of freely producible goods, there is substantial identity of cost and price; but this is because the price of the product controls, and the price of the cost goods is the controlled. The law of costs is not against, nor beside, but within the law of marginal utility.

In order fully to understand the Austrian theory of value, we must note the abstract conditions which are assumed. Böhm-Bawerk may be taken as representative, and he appears to proceed in a well-nigh Ricardian manner to conjure up economic men acting in frictionless competition. As preliminary assumptions, come the statements that each individual will seek only his own direct advantage, and accordingly that each will exchange only when an advantage is to be gained, will prefer a greater to a less advantage, and a small gain to none. Also, exchange is to be regarded as economically possible only between persons who value goods differently — yes, oppositely. When we come to the common case, of two-sided competition, we find the reasoning all based on a situation in which no individual makes a mistake in following his self-interest; while, on the side of goods, all units must be exactly the same, and it must be possible to make additions to the stock.

Distribution, Especially Capital Interest Theories. — The theory of distribution involves a valuation of the services of the factors of production. It is in the application of their theory of value to "production goods" that the Austrians have found most difficulty in developing their thought. They have made their greatest effort in the direction of a theory of capital and interest, and this may well be considered in detail.

The Austrians have differed among themselves as to the true theory of interest. Menger and Wieser supported what may be called a productivity theory; while Böhm-Bawerk held what has been rather unsatisfactorily called an exchange theory, or, sometimes, a value theory. Menger, for instance, states that the use of capital, assuming it to be scarce, gives rise to a value in the anticipated product over and above the other means of production employed, and that this increment of value represents the "power of disposal" over the capital goods used. This power has a distinct value as a means of production. And Wieser bases interest upon the productivity of capital as its cause. Taking a series of cases of production in which different proportions of capital function, he concludes that a part of the product which varies with the amount of capital, is imputable to capital. The "productive contribution" imputable to capital is the direct cause of interest.

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[1] See *ibid.*, above cited, p. 537.

On this point, Wieser criticizes Menger, who had attempted to solve the problem from the other side, so to say, by observing what is lost when capital or units of capital are removed from the productive complex, — a sort of negative imputation.

As to this imputational reasoning, the critic will note that the question, *why*, still remains. Granting an empirical relationship, what is *its* explanation? [1] What is the cause? How is the exact amount of the share that is imputable to each factor, determined?

Böhm-Bawerk, in his book on *Capital and Interest*, says that the interest problem is one of determining the causes which guide into the hands of capitalists a part of the stream of national production. He makes an interesting distinction among different sets of interest theories: naïve productivity theories which regard the shares in distribution as separate from the beginning; exploitation theories which look upon the shares as forming one stream to the end, where labor is robbed; the value theory, which, in a sense, lies between the two, holding that the stream begins to separate when it comes under the influences which create value.[2] This is his theory, and according to it the explanation of interest lies in the valuation process, — in the fact that men tend to value the same good more highly in the present than in the future.

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[1] For detailed criticism see *Ann. Amer. Acad.*, V, 522 f. (Green); and criticisms on similar theories of J. B. Clark and his followers.

[2] *Capital and Interest*, pp. 421 f. Böhm-Bawerk also distinguished "use," "abstinence," and "labor" theories.

On the capital-and-interest question, then, Böhm-Bawerk differs with Wieser, denying the validity of the theory of imputation, and basing his reasoning upon the "technical superiority" of roundabout processes of production.[1] In a roundabout process of production, instrumental or capital goods are used, which, on account of the remoteness of their availability for consumption, have a relatively low present value. As such production goes on, the capital goods are transformed, or "ripen," into consumers' goods of a higher present value. As a result of the time element, therefore, there is a growth of values in excess of labor costs, from which excess interest flows as a permanent net income. To state this idea in another way: roundabout methods of production require the use of future goods, or capital. By exchanging present goods for future goods, therefore, the capitalist can secure the larger results of the roundabout process at some time in the future. To be sure, at the outset the smaller quantity of present goods represented by capital has greater value than the large quantity of future goods, but in time the future goods become present goods, and then their value exceeds that of the quantity originally advanced. This excess, or premium, is interest. In short, the difference between the value of capital goods and the value of consumers' goods explains interest in all its forms.

All this stands opposed to cost theories of interest, as, for example, Senior's abstinence theory. Senior gave a place to the time element, but it was of the cost of waiting and abstinence involved that he thought. Böhm-Bawerk denies that abstinence is an independent sacrifice, holding that it cannot be added to labor pain to get a cumulative total cost.

To illustrate his attack, and the criticism of that attack, take this passage. The planting of fruit trees is mentioned, and the alternatives of a destructive storm and undisturbed fruition in ten years, are assumed. Böhm-Bawerk asks, Is my sacrifice any greater if the storm does not come and I wait ten years for the fruit? — thinking that the answer must be no, and that therefore abstinence cannot be taken as a basis for explaining interest on such an investment.[1]

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[1] In criticism see Landry, "Productivity of Capital," *Quart. Jr. Econ.*, 1909, p. 585; Bortkiewicz, "Der Cardinalfehler der Böhm-Bawerkschen Zinstheorie," *Jahrb. für Gesetzg.*, 1906; Bleicher, "Gegenwart u. Zukunft in der Wirtschaft," *Jahrb. für Nationalök.*, 54:347; and the writings of Professor Irving Fisher.

But the answer should be: The question is misleading. As well ask, if one orchard bears 100 bushels in ten years, and an equal orchard bears 100 bushels in fifteen years, would productivity be greater in the later case? — and, if the answer be no, conclude that the time element, or difference between present and future estimation, plays no part.

At this point, Böhm-Bawerk confounds general with special values. In the long run, interest rates must normally be high enough to cover the losses — the unrewarded abstinences.

In a supplement to *Capital and Interest,* called *Recent Literature on Interest,*[2] Böhm-Bawerk argues that, if a good equals 10 in value now and 6 five years hence, it would be uneconomic to undergo sacrifice in labor and waiting to exceed the latter amount, or 6, and that there is thus no room for any "sacrifice" aside from labor, or the money payment therefor. This mode of procedure, however, *assumes* the future value, 6. But the 6 cannot be taken for granted: the sacrifice is not limited to 6, but to 10 − 6 (?), and plays a part in determining whether it is to be 5, 6, or 7.

The truth appears to be that the relation of future value to present value in the interest problem is a more complex one: the future gratification is worth less, partly because of the sacrifice which is involved in saving and waiting. This disutility enters immediately into the estimation of the future. Then interest *must* be paid — Böhm-Bawerk explains how it *can* be paid — because men are unwilling to submit to any greater sacrifice than is indicated by that estimation of future value

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[1] *Capital and Interest,* p. 281.

[2] Translated by Scott and Feilbogen. Chap. IV.

(6 ?). It is only by introducing cost that the share imputable to any particular factor of production can be determined.

The *general shortcoming of the Austrian theories, both of value of cost-goods in general and of interest in particular, lies in the assumption of an independent value existing in the products secured, which value they seek to reflect back upon the instruments of production.* But, having thrown out cost as a coördinate element in the valuation process, they have no definite connecting link or limiting factor. Only by introducing cost is it possible to show why reproducible goods *must* have value, and why a part of that value must be returned to each by means of production.

It is another shortcoming of Böhm-Bawerk's thought that he ignores the problem of the determination of wages, leaving unanswered the question, how is the product divided between labor and capital? Wieser, in his *Social Economics,*[1] gives us what is probably the best-rounded attempt at a complete theory of distribution based on marginal utility which has come from the leaders of the Austrian School. It is a "marginal productivity" theory based on the specific imputation of shares to labor and capital. The entrepreneur's income consists of wages of management, interest on invested capital, and possibly an element of pure profits imputable to the entrepreneur function as such. Rent is much the same as in the Ricardian theory, only the margin depends not on cost but on the imputed productivity of the instruments of production other than the rent-bearing agencies.

Followers of the Austrian School. — Among the followers of the Austrian School, Robert Meyer (*Principien der gerechten Besteuerung,* 1884; *Das Wesen des Einkommens,* 1887); Launhardt (*Mathematische Begründung der Volkswirtschaftslehre,* 1885); E. von Phillipovich (*Aufgabe und Methode der Politischen Oekonomie,* 1886, and *Grundriss der Politischen Oekonomie,* 3d ed., 1889); Emil Sax (*Grundlegung der theoretischen Staatswirt-*

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[1] For an excellent review see Mitchell, "Wieser's Theory of Social Economics," *Pol. Sci. Quart.,* March, 1917.

schaft, 1887); and Robert Zuckerkandl (*Theorie des Preises*, 1889), are especially noteworthy for writings which show independent thought.[1] Launhardt gave the Austrian theory a mathematical formulation, in this resembling Walras. Sax has supplemented Böhm-Bawerk's work by analyzing the separate functions of subjective and objective value in economic life, and by showing the bearing of the marginal-utility theory on public policy. He argues, for example, that taxes should be in proportion to the value of the services to be performed by the state as estimated by the citizens, and that the state should not take goods out of individual hands when they will yield a greater net income if individually held. Philippovich, however, is the leading general theoretician, and his *Grundriss* has had many editions and wide influence. In it he criticizes Böhm-Bawerk's theory of interest. He rejects the idea of opposing the value of present consumption goods to the value of future goods, stating that actually we compare the values of the present goods represented by capital with an estimated value of future consumption goods. The fact that this comparison is generally in favor of the entrepreneur is the result of the existence of unsatisfied wants for consumption goods. L. Mises (value of money and cycle theory) and F. A. Hayek (cycle theory, capital and interest) are notable recent exponents.

The Italian, E. Cossa; the Frenchman, Block; the Englishmen, Wicksteed, Edgeworth, and Smart; and the Americans, Patten, Clark, and Fetter, were influenced by or in sympathy with the Austrian School. Also the Dutch economist, Pierson (*Leerboek*, 1884).

Philosophy and Method.[2] — The philosophy which underlies the economics of the Austrian School is highly individualistic, and more particularly it is that phase of utilitarianism that is known as hedonism. The Austrians appear to assume that the good is known by balancing pleasures and pains, and that well-being is at a maximum when the number of those who have more pleasure than pain is the greatest. At least, this is their tendency.

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[1] Mataja, Seidler, and Komorzynski are also to be mentioned.

[2] If the reader who is not versed in philosophy has not read the general introductory discussion of the relation between philosophy and economics (pp. 8–20), he can hardly expect to understand this section readily. The student should review it at this point.

In the first place, self-interest is made supreme. Thus, Böhm-Bawerk says: "For the generally recognized principle of economy lies in just this, to seek the greatest utility with the least sacrifice." [1] Furthermore, the leading idea of the School is that the object of desire is pleasure, and that all volitional acts — which acts they regard as predominant — have happiness as their goal. "In the last analysis," writes Böhm-Bawerk, "according to our theory, it is with feelings and sensation quanta that we have to reckon." [2] In exchanging, we compare the pleasures which are attached to the enjoyment of different goods; and for the most part we do this in a rational way. "Fiery enthusiasm for ideals and elementary outbursts of instinct have a far greater part in extra-economic acts than in the cool, calculating deliberations which assign to a good its economic value based on the most rational use."

This philosophy, proceeding as it does upon the ground that men's ends are states of consciousness [3] and that men's actions are guided by reason, is at the bottom of the subjective standpoint of the School.

It is of fundamental importance, then, to inquire if this philosophy be sound. Without attempting to pass final judgment, one may say that it has been subjected to much serious criticism, — so much and so serious as to warrant the conclusion that it is an imperfect basis for a system of economics.[4] Briefly, it has been objected that in making pleasure that object of desire, the desire is taken for granted and so the cart is put before the horse; for we do not desire things — not in large part, at least — because they are pleasurable, but rather they are pleasurable because they gratify desires.

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[1] *Positive Theory of Capital* (last German ed.), p. 332.

[2] *Ibid.*, Vol. 1, p. 331.

[3] ". . . *es sich nur um ein mehr oder minder von lust oder genuss handelt*" (*ibid.*, pp. 318–319).

[4] See Martineau, *Types of Ethical Theory;* Green, *Prolegomena to Ethics;* Sidgwick, *Methods of Ethics;* James, *Principles of Psychology;* Dewey and Tufts, *Ethics;* Urban, *Valuation, Its Nature and Laws.*

There is a wide difference between the two ways of looking at the matter: The hedonist of the sort represented by the Austrian School tends to regard the individual as having a sort of passive mind, registering sensations determined from without, and grinding out calculations according to the laws of reason. He assumes that sensations and valuations are directly related. His critics emphasize character as the basis of desire, and the predispositions to desire as shaped by biological and social factors. Thus, they would attach much greater importance to instinct and imitation as elements in guiding economic activity. Inasmuch as men have *innate* desire tendencies, they say, we find them sometimes valuing things that do not give pleasant sensations, and attaching degrees of value that are not in proportion to the pleasure derived from pleasant ones.

Naturally, taking such a view of the mind and its functions as they do, the Austrian hedonists have been criticized for failing to consider "personal references" in the valuation process, the point being that objects often acquire imputed values through explicit acknowledgment on the part of the subject for whom they exist, the feeling of possession ("pride of ownership"), for example, being more than a mere feeling of the worth of the object and not proportional to "sensation."

When it comes to classifying the thought of the Austrian School under the heads of idealism or materialism, a certain measure of dualism is found — as is usually the case. The Austrians emphasize human wants. They appear to regard man as acting upon prospective pleasures and pains, unhampered by objective limitations, and to minimize the importance of costs and scarcity in the determination of marginal utility. Their philosophy, therefore, shows traces of idealism, or of tendencies toward idealism. Moreover, we find among the members of the School a not infrequent resort to a kind of social point of view; and certainly their method is deductive. Founded on subjective elements, with utility as the dominant force, the doctrine would seem to start with an idealistic slant.

But as the structure of their reasoning is raised, things material come to play a larger and larger part. We observe that, after all, utility is made to depend upon the material — upon sensations, and upon the way in which goods present themselves to the senses. The Austrians, moreover, were individualists, and opposed Socialism at every turn. Their marginal utility was the *individual's* feeling of the importance of a good in view of the number of units of the good available to him; nor did they attempt to conjure up a social mind to serve as the seat of a social marginal utility.

We have made the attitude assumed towards man's ability to deal with the "forces of nature" a practical test of theories concerning mind and matter, as these theories are manifested in economic thought,[1] and on this score clear evidence may be found of a dominant strain of materialism in the Austrian doctrine. Wieser is, after all, the most philosophical representative of the School, and in his *Natural Value* he clearly accepts the idea that man can never hope to gain the upper hand in his striving to satisfy his wants that depend on physical acts; for he reasons that exchange values must for the most part ever run parallel with utility, and that is to say that scarcity will ever attend wants. This reasoning is evidently based upon the theory of the indefinite expansibility of human wants, which makes it impossible for supply so to gain upon demand as to cause total values to descend while total utility and want gratification are increasing.

The conclusion to be drawn from this brief examination of the philosophical background of the Austrian School's thought is that there are inconsistent elements in that thought which would have to be carefully fused into a synthesis if the system were to endure. Based ostensibly upon utility, and proceeding through subjective analysis, it would logically be associated with idealism, and with a social point of view according to which the interests of society would coincide with those of individuals. It would, in fact, either assume that individuals in following their several desires would be led to act in harmony, or that Society would dominate individuals; and either of these extremes would lead to the acceptance of *total* utility as the test of value and productivity.[1] But instead, the Austrians turn to the individual and the concept of the margin. Individual estimates must be limited by individual possession of goods, and margins are of significance as expressing not only degree of utility but also degree of scarcity. Thus the material environment plays a large part.

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[1] See above, p 16.

While, as has been suggested, the truth lies in a synthesis of idealism and materialism, the Austrian doctrine, especially in its attitude toward objective limitations, falls short of the requisite balance: idealism dominates in the philosophical basis, but in the structure reared upon it, the materialistic element predominates.

But if this criticism of the philosophy is sound, what of the related subjective theory of value? To put utility forward as the force which controls valuations, would also be putting the cart before the horse, and to assume a parallelism between sensation and utility (the Austrian's subjective value) is to overlook a considerable part of the conditions of human choice. Of the economic aspects of these points more will be said in the next section.

The Austrian School's theory brought a desirable development in the way of a treatment of the relation between subject and object; and it added to the Classical theory in this respect. The emphasis of value as being the importance of an object as recognized by a subject was bound to lead to a truer and more human economics. Through reference to "the marginal man" it was bound to kill the unreal "average man" of Smith and Ricardo. The members of the Austrian School themselves, however, developed their subjectivism around an unreal "subject"! They based it upon an erroneous psychology.

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[1] It is interesting to note that Professor J. B. Clark is more consistent on these points. He, in his *Philosophy of Wealth*, accepts society as an organism, and regards value as expressing marginal utility to society as a whole. This is a kind of total utility and corresponds to what *to any individual* might well seem total utility in the usual sense. Professor Clark is also more philosophically consistent in his optimism and in his conception of costs. He does not adopt the opportunity-cost ideas of the Austrians.

The method commonly and most easily associated with a philosophical background such as that described on the preceding pages, is abstract and deductive. Above all its abstract character is to be emphasized. The Austrians themselves have used the words "exact" and "isolating" as characterizing their method, by the former meaning an exactness reached by simplifying the premises used, and by the latter the abstracting of a single factor or relatively simple group of factors for use in reasoning. Thus the essential characteristic of the method is its simplification by removing complications, — which means an abstract procedure. Human motives are used as a basis, but first they are reduced to a workable form by adopting a hedonistic analysis. No better example of such methodology could be found than Böhm-Bawerk's development of the "laws of price" in the *Positive Theory of Capital.*

But abstraction is the beginning of deduction, and accordingly the Austrians make diminishing utility the starting point of a "system" built up by proceeding from the general and simple to the particular and complex. This is illustrated in their unfolding of a theory of value from the premise of diminishing utility, and a theory of interest from the premise of a preference for present over future enjoyments. E. Sax may be said to have attempted a similar procedure in finance (*Die Verkehrsmittel in Volks- und Staatswirtschaft,* 1878–1879). The spirit of the school is seen in the words of Wieser who somewhere says that the laws of value are to economics as the laws of gravity are to mechanics.

Some of the errors found in the theories of the Austrians are to be attributed to what is a weakness in their method, namely its tendency to overlook the importance of ample verification and due allowance for complicating circumstances.

Critical Estimate and Summary. — The leading Austrian economists are justly called a "school." In the first place, they have worked in virtual collaboration; then, they agree in centering attention upon value, their value theory being their chief doctrine; and finally, they proceed from a common psychology, hedonism, and pursue a common method, the deductive, in this opposing themselves to the Historical School.[1] Even compared with Jevons, they are distinct; for he, making value a relation between goods, followed an objective exchange concept, while they on the whole hold to a purely subjective theory. Thus they make more use of psychology, and less of mathematics, than did Jevons.

The essence of the Austrian economic thought lies in its quest for an ultimate and unified analysis of the causation of value, based on subjectivism. And it may be observed in advance that its achievement has been a deeper analysis of valuation psychology, and a coördination of theories.

The significance of the school appears most clearly in contrasting it with the doctrines of the Classical School. The Ricardian economics makes value equal effort expended, — and wealth equal effort saved; the Austrians make value equal utility (marginal), — and wealth equal utility or satisfaction secured. The Ricardian theory is, in a sense, dualistic, referring now to utility, now to labor or effort; the Austrian theory might be called an attempt at monism, the effort being made to base it upon utility alone. Thus Ricardo made two laws: one for non-reproducible commodities — scarcity value; the other for reproducible ones — cost of production. But the Austrians fit costs into their unified scheme, arguing that it is not cost which functions, but limitation of supply, and cost indirectly through such limitation. Wieser writes: "We have tried, above all, to abolish the dualism of labor and utility, that combination of irreconcilable causes, which only proves that the true cause has not yet been recognized." [2]

Accordingly, while the Classicists refer to temporary fluctuations and natural levels as controlled by different laws, the Austrians say there is one law for both; and what the former distinguish as "value in use" and "value in exchange," the latter combine as "subjective value." It is fairly obvious, however, that with their own distinctions between cost goods and monopoly goods, cost instruments and specific instruments, and the like, the Austrians themselves return to a sort of inconsistent dualism.

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[1] Menger and Böhm-Bawerk both are versed in history, and neither is blind to its merits.

[2] "The Theory of Value," *Ann. Amer. Acad.*, II, 603.

It should be noted, furthermore, that they made an important contribution in analyzing the different phases of subjective and objective values and their interrelations. And in this connection, they effectively laid the ghosts of "absolute value" and "inherent" value, which haunted the Classical economics. Unfortunately, however, they raised other ghosts — an unreal "marginal utility" and a sort of absolute "marginal productivity."

Finally, a great merit of the Austrians is their *attempt* to extend their theory of value in a logical way to the factors of production and to the distribution of income among them. Ricardo limits his theory of value to commodities, and it will be remembered that J. S. Mill was criticized for not broadly coördinating his theory in this regard. Menger, Wieser, and Böhm-Bawerk, however, attempt to extend their value theory to the means of production. Wieser states: "We also wished to bridge over the chasm which yawns between the theory of value and that of distribution and especially of interest." [1]

After all has been said, it is nevertheless true that the Austrian School's economics is essentially "Classical." This appears in their opposition to Socialism and Historicism. It appears in the fact that their main ideas were soon to be combined with Classical doctrines to establish a Neo-Classicism. After all, Classicism rested upon a philosophy and a psychology. The Austrians in their large element of materialism, their individualism, and their hedonism, were at one with the Classical economics.

[1] *Ibid.*

Marginal Utility. — Criticism of the Austrians' philosophical basis, of their inadequate recognition of the part played by costs, and of the one-sidedness of their interest theory, has already been suggested. It remains to consider the meaning and importance of marginal utility, the concept which is the center of the Austrian School's economic thought.

The one great criticism results from their failure adequately to analyze marginal utility, a failure which accounts for their one-sided adoption of a single element in the complex marginal-utility concept as representing the whole.[1] The Austrians centered their theory upon the want, although marginal utility is itself an expression not only of wants, but also of limitations upon the satisfaction of wants set by supply conditions, including the material and the institutional environments.

More than this, — in addition to their one-sidedness, — their treatment of wants and utility shows serious shortcomings, as follows.

(1) On the utility side, (*a*) their theory has the limitations of one based upon a pleasure-and-pain psychology (Hedonism). In building up a theory of value, their fundamental hypotheses deal with mere sensations, or possibly feelings. But sensations are not, as such, pleasures; nor are pleasures desires; nor are desires values. We may have sensations without desire, and desires without sensation. Therefore, *sensation cannot be the basis of value.* The true chain of causation is: First, the character and "desire disposition" of the person; second, the desire; third, the gratification of the desire. The pleasurable sensation (if one is involved) does not determine the desire, but depends upon it.

(*b*) The Austrian theory is too individualistic — too rationalistic in that it overlooks important institutional facts, and important motives. *The individual's desires depend partly upon impersonal valuations which are affected by participation with*

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[1] For criticism of the Austrians see the writings of Dietzel, Lexis, Gerlach, and Bortkiewicz, in German; Bonar, Carlisle, Macvane, Veblen, and Davenport, in English; Landry, in French; and Loria, in Italian.

others in social valuation processes. Customs and moral judgments affect him. The existing distribution of income affects his purchasing power. Also much non-rational psychosis affects him, as for example the important part played by instincts. Put in general terms, the Austrian theory is too abstract.

(*c*) It cannot be said that the Austrians have succeeded in bridging the gap between individual sensations and the phenomena of market value or price. Marginal utility is a purely individual phenomenon. It is difficult, to say the least, to compare men's judgments, the difficulty lying chiefly in the differences among individuals' sensibilities, tastes, and purchasing powers. Yet such a comparison is necessary in order to arrive at an exchange value. In no real sense can there be a social marginal-utility scale. The Austrians leap from a purely subjective basis to a conclusion concerning objective phenomena.

(*d*) The quantitative relation of marginal utility to value is not scientifically demonstrable, but at best rests upon a loose, empirical basis. No exact measurement is possible, as value is not a quantity in the mathematical sense; and, while value may generally move in the same direction as pleasurable sensation, — if and when related to such sensations, — no quantitative relation can be assumed.

(2) On the marginal, or supply-limitation side, the Austrian theory is subject to the following adverse criticisms. (*a*) The margin is but an index of a total situation, and the marginal unit is marginal only because the total number of units is what it is. In fact the total utility is greater than "marginal utility × number of units." This fact the individual may recognize, and in case he anticipates possible scarcity his valuation will be affected. (Thus we account for the Austrians' insistence on the assumption that additions can be made to the stock of goods under consideration.)

(*b*) The essentiality of a consideration of cost, such as has not been given by the Austrians, has already been stated. They have failed to cover the valuations of producers or sellers, and the determination of sellers' offers, a difficulty which they try to escape both by reducing cost to utility and by minimizing the seller's part in exchange. Perhaps this failure lies at the bottom of their inadequacy in the theory of distribution.

Under this head, a point deserving criticism is the adoption of a conception of cost which makes it depend upon utility; thus, by definition, eliminating consideration of what may crudely be called pain cost. We find the Austrians referring the cost of one good to the utility of another good that must be given up to get the former; and so on without end. In short, they would allow costs to exist only when "alternatives" exist, and they would regard costs as being dependent upon and measured by the "opportunities" that present themselves. They do not see that, when we come to production, an "opportunity" can be measured only by comparing the *net* advantage of taking one alternative with the *net* advantage of the other. But the net advantage is found only by comparing income with expense; and expenses are what they are because of the unwillingness of men to undergo the risks, irksomenesses, and fatigues of production.

This shortsightedness is associated with a narrow individual point of view; for it is only an individualist who could be content to stop his analysis of cost with "outlay expenditure," and not inquire why such outlay is necessary. The individual business man takes his "expenses" for granted; but the economist, in the interest of society, will ultimately go back of expenditure to the causes that limit the factors for which the outlay is made.

One result is the tendency of marginal utility theorists (Austrian and other) to rely upon a "marginal productivity" theory of distribution, thus assuming the location of the "margin" for the utilization of each factor of production.[1] In this way, they avoid cost, but they are left without any adequate explanation of the total product or the specific contributions of the several agencies of production.

(3) The theory does not cover all important value phenomena, and the exceptions are so important as to overthrow the "rule."

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[1] Böhm-Bawerk attempted to get away from this.

Among these exceptions are the following: All cases of imperfect competition and of barter, cases of one-sided competition (among sellers), reproducible goods, labor (?), money (?). An hypothesis which will not work in cases of monopoly, nor unless the "marginal pairs" are very close together — one which forces us to resort to the cost of a substitute when a good can be duplicated — one which has not been successfully applied to the valuation of labor or money, — such an hypothesis is not satisfactory as the basis for a theory of economic value.

The absence of any adequate treatment of wages is a notable deficiency in the Austrian writings.

It is the generally accepted fact that the leaders of the Austrian School have served to broaden and clarify our ideas by emphasizing the subjective; but perhaps a majority of economists will now admit that both the novelty of their theory and its significance as providing an adequate basis for reconstructing economic science, have been overdrawn. Objective limitations remain as an important factor necessary to the explanation of valuation levels.[1]

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[1] This, in the last analysis, is all that Professor Veblen means when he points out that the marginal-utility theory is optimistic, teleological, and not based on a cause-and-effect relationship. By adopting a purely subjective standpoint, for example, man is regarded as acting upon future consideration with an abstract belief in his power to control his destiny. And, in assuming that men act merely upon estimation of prospective pleasures and pains, a truly scientific cause-and-effect basis is impossible. (Cf. Veblen's article in *Jr. Pol. Econ.*, XVII, 620, 1909.)

2. NEO-CLASSICISM

CHAPTER XXXII

MARSHALL, AND HIS SYSTEM OF EQUILIBRIUM [1]

The subjective value economists, and notably the Austrian School, undertook to reconstruct the Classical economics upon a foundation of "utility." Alfred Marshall (1842–1924) undertook to utilize the new thought material supplied by the subjective school in building a deeper and stronger foundation, and at the same time to maintain and improve the old structure. He, like the Austrians and Jevons, sought reconstruction; but unlike them, he saw that much of the Classical doctrine was sound and logically habitable. By breaking down partitions, cutting windows, and adding rooms, he remodeled the Classical system so effectively that since the appearance of *Principles of Economics* in 1890, his "Neo-Classicism" has become recognized in the English-speaking world as the most secure, convenient, and harmonious stopping place now available for economic science.

Marshall is not to be thought of as seeking to demolish the economics of Smith, Ricardo, and Mill. He sought to supplement it. He sought a synthesis, first of the utility theory of the Austrians and the cost theory of the Classicists; second of the various conflicting elements in the thought of those who on the whole accepted the Classical doctrine. He was no mere eclectic. Least of all was he a mere critic. With understanding, depth of insight, and great logical consistency, he saw truth in disconnected or seemingly antithetic doctrines, and put them together as a connected whole. Marshall's synthesis, as we may call it, is not perfect, but it is a masterpiece, and *as a whole* has probably never been surpassed as an explanation of economic life.

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[1] Marshall's chief works are: *Economics of Industry* (1879); *Principles of Economics* (1890; last or 8th ed., 1920); *Industry and Trade* (1919); *Money, Credit, and Commerce* (1924). On Marshall, cf. the following: Keynes, J. M. (ed.), *Official Papers of Alfred Marshall;* Pigou, A. C. (ed.), *Memorials of Alfred Marshall* (1925); Homan, P. T., *Contemporary Economic Thought* (1928), pp. 195–280; Davenport, H. J., *Value and Distribution* (1908), Chap. XX; Scott, W. A., *The Development of Economics* (1933), Chap. XXVI.

Marshall was born in London. Coming from a "middle-class" family of moderate means, he received a good schooling in the classics, and then specialized in mathematics at Cambridge. But here he became acquainted with T. H. Green, Maurice, and Sidgwick, through whom he gained an interest in philosophy, and he studied Kant and Hegel. Soon he came under the influence of developments in biological thought, and the Darwinian concept of evolution became part of his mental equipment. Then, too, as his acquaintance with the social sciences grew, he was influenced by the Historical School — especially by Schmoller and by Toynbee — and the doctrine of relativity was impressed upon him.

As he developed as an economist, he familiarized himself with the thought of Jevons and the Austrian School. He examined the theories of F. A. Walker, the American economist. He delved into the less known works of Cournot, von Thünen, and other Continental writers.

Thus our young mathematician became a broadly trained master of social science, — he was professor of economics at Cambridge from 1885 to 1908 — well equipped to carry on the work of reconstructing the body of economic doctrine inherited from his English predecessors. For that is what Alfred Marshall did. He, in a real sense, started his system of economics with Mill, much as Mill had started his with Ricardo. (Indeed, it is not difficult to find kinship of spirit between Mill and Marshall.)

Certainly circumstances were propitious. The Classical doctrines of John Stuart Mill, which had been ascendant in England for thirty years, had been seriously undermined, and economics had again fallen into disrepute. As the generation which had known the Napoleonic wars, and the tariff and currency issues which followed, passed, the center of interest had shifted. Militant Socialism and an organized labor movement attacked

Classical economic doctrines as formulated by Ricardo. The Historical School effectively challenged some of the postulates assumed by Smith and Ricardo, and emphasized the complexity and changing character of economic life. Finally, the Austrian School and Jevons exposed the weakness of a theory of values determined solely by cost.

Meanwhile, great changes had occurred in the technique of economic life. Numerous inventions and an undreamed of use of machinery; frequent rapid and sweeping readjustments in employment and enterprise, and clearly marked business cycles; banking and financial developments based upon the growing use of credit; trusts and cartels; and withal, an expansion of the part played by the state in regulating economic life — these were among the changed conditions which confronted Marshall.

Marshall's Economics. — "Political Economy, or Economics," wrote Marshall, "is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being."[1]

At once we note the references to "business," "individual action," and "material requisites." But at once, too, we note that it is the business of *life* with which he is concerned, that the materials are of interest as requisites of *well-being*, and that individual and *social action* are both involved. Economics is a study of *mankind*. The key to Marshall's synthesis is his concept of the science as a two-sided study of "wealth" and "man," with the latter primary.

This approach, however, leads him to no denial of law or minimization of the scientific character of Economics. Marshall thinks that Economics must be a science, and that therefore it must deal with the measurement of the regularities or uniformities which he is sure exist in individual and social action. It differs from the physical sciences, chiefly, if not solely, in that it deals with the "ever changing and subtle forces of human nature."

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[1] *Principles of Economics*, 8th ed., p. 1.

Such being the case, Marshall consciously and specifically limits economic science to such forces as are subject to measurement in money.[1] The force of human motives and the relation between pleasures and pains, while not directly measurable, can be approximately measured by the sums of money required to induce individual action. In this connection, we note he considers that money has marginal utility to individuals.

This is not unlike Bentham's conclusion,[2] and would have been accepted by the Classical economists. But Marshall greatly limits the field for such measurements, and is careful to point out the abstraction involved. They do not express sums of satisfaction; and differences in individual sensibilities and incomes must be allowed for. Custom and habit are factors in human choices. Men sometimes work for the pleasure of working, for the approval of their fellows, or for power. He points out that the motives to voluntary collective action are great and growing.

In short, Marshall proposes to limit economic science to dealings with one side of man's life, studying individuals as members of industrial groups, and relying much upon the uniformities of action which appear when the averages of large numbers of persons are considered.

The goals or ends of life, and the *quality* of human motives, are, as Marshall puts it, "more the concern of the philosopher" than of the economist.

Yet strangely enough in an academic scholar — though true to the Classical tradition — this Cambridge professor always had practical values in mind. He says, "the dominant aim of Economics in the present generation (!) is to contribute to a solution of social problems."[3] Like most of his great English predecessors, Marshall was a great humanitarian.

In this mixture of abstract scientific approach with an interest in practical humanitarian goals, as well as this emphasis on the money measure while he dwelt at length upon its limitations, we find elements both of strength and of weakness in Marshall's thought. It represents an attitude that kept him from undue simplification and from hedonistic ethics. But it results in a certain lack of definiteness and clarity which at points amounts almost to confusion. One must feel that a little more heroic abstraction, and a more rigid adherence to the field of clearly measurable individual choices, might have been more fruitful.

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[1] *Principles*, Bk. I, Chap. ii. [2] See above p. 248. [3] *Principles*, p. 42.

On the one hand, we find the following: Marshall sought an abstract science dealing with only a part of man. He explicitly assumed the existing society — present property rights, free individual initiative predominant in business, etc. — subject only to gradual change. This would suggest a positive and "provisional" science.

Moreover, his whole approach is based upon the concept of an equilibrium of causal forces. He did not merely describe economic life. He did not fall back upon predetermined mathematical "equations." He did not shift the burden of explanation to "social control" through institutions.

But, on the other hand, Marshall tried to deal with actualities, — with concrete realities. And he made a great effort toward unified treatment of life. The "principle of continuity," as he calls it, is generally in his mind, and leads him to consider all human motives which act regularly, including ethical forces.[1] First, he sought to deal with complex interrelations among economic forces, and to allow for the minute gradations by which various economic goods and incomes shade into one another. Second, he undertook to allow for changes which come in time, and for an evolutionary continuity. The result is that he seems to be striving, after all, for a complete and final statement.

More than any other economist who has accepted the idea of positive economic laws and equilibria of causal forces, Marshall attempts to allow for changing institutions and to introduce into his system of economics the complex interrelations and minute gradations of phenomena. It is a powerful effort. It was a worthwhile effort, as its influence has proved. Certainly it effectively exposed the limitations of economics as a science, and at the same time pointed out its bearing upon the whole of human life. But we may well doubt whether so sweeping a synthesis as Marshall attempted is possible.

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[1] *Principles*, Preface to first ed., p. vi.

Value: Demand and Supply. — Marshall's economics centers in the problem of the determination of value, which he consistently regards as a problem of equilibrium between the dual forces of demand and supply.

Ricardo had suggested such a unification of treatment, but did not fully accomplish it. The Austrians and Jevons made value the center of their thought, interweaving "distribution" therewith. Marshall brings all economic processes more clearly and logically within the focus of value than his predecessors, and his greatness as an economic theorist rests largely upon the measure of success he attains in establishing the "price system" as a scientific explanation of economic life.

Somewhere he says: "In spite of a great variety in detail, nearly all the chief problems of economics agree in that they have a kernel of the same kind. This kernel is an inquiry as to the balancing of two opposed classes of motives, the one consisting of desires to acquire certain new goods, and thus satisfy wants; while the other consists of desires to avoid certain efforts or retain certain immediate enjoyments . . .; in other words, it is an inquiry into the balancing of the forces of demand and supply . . ."[1]

By demand, in this causal sense, Marshall means a schedule of what he calls the "demand prices" of the potential buyers of a commodity. Each individual buyer has a "demand price" which reflects an equilibrium between his marginal utility for the good in question and (usually) his marginal utility for money. Naturally, the law of diminishing utility plays an important part. Similarly, supply means a schedule of the "supply prices" of would-be sellers, these reflecting their several costs and the marginal utility of money to them.

Value is determined as an equilibrium between these series of

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[1] *Principles*, 2d ed., p. 383. (This form of statement was subsequently omitted by Marshall.)

"demand prices" and "supply prices." They may be represented graphically by two "curves," whose intersection approximates the equilibrium point. At this point, the marginal demand price and the marginal supply price for the quantity of goods exchanged, would be approximately equal.

Thus Marshall utilizes some of the Austrian School's analysis on the demand side, while retaining cost factors as developed by the Classical School, on the supply side. His position is indicated by his well-known analogy: value is like the keystone of an arch, the two sides of which are demand and supply.

In his treatment of demand and supply, he presents excellent discussions of "elasticity," and of "joint" and "composite" conditions, for which he deserves credit.

But the time factor enters the problem of equilibration, and Marshall follows his Classical predecessors in distinguishing "market values" from "normal values." The former are "temporary equilibria" which "depend little, if at all, on calculations with regard to cost of production," but on present demand and stocks available. Demand is the active factor in short periods, and the price tends to be low enough to allow the marginal buyer to clear the market. "Normal values" are "stable equilibria" which would be attained if sufficient time were given to allow the normal action of economic forces to work itself out. His conclusion is that "the value of a thing tends in the long run to correspond to its cost of production." [1] In other words, normal value tends to equal cost of production.

The term "normal," however, may be used in two senses.[2] In one case, which Marshall calls short-period, or sub-normal, the existing raw materials and appliances of production have to be taken for granted, and marginal supply price is that which will induce producers to produce all that they estimate will be worth their while with existing equipment. In this case, there is insufficient time or ability to adjust production costs (and demand would play a more decisive part). In the other case, which he calls long-period, or true normal, the "normal action" of economic forces could work out more fully, and equipment, labor force, organization, and volume of production could be fully adjusted. Presumably this would take more time. In this case, the "marginal supply price" would become such as barely to induce capitalists and laborers to supply their services (which evidently means to Marshall much the same as barely covering their costs).

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[1] *Principles*, p. 348.

[2] *Ibid.*, pp. 497–498.

Thus, with great refinement, many distinctions, and expanded analysis, Marshall arrives at the old conclusion of a market price determined by the "higgling of the market," and a natural value ("normal price") resting upon or "corresponding to" cost of production. The explanation is more ample and satisfying than can be found in Smith, Ricardo, or Mill. The treatment of demand is incomparably better, and "costs" are considered more comprehensively and consistently. The result is much the same!

But what is "cost of production"? Marshall is keenly aware of the difficulties of the concept and of some of the limitations involved in accepting money payments as measures of cost. He draws a clear-cut distinction between the "real cost of production" and the "money cost of production," and suggests that the latter be always referred to as "expenses." The "real costs," he states, are the "exertions of labor," the "abstinences or waitings" of savers of capital — all the efforts and sacrifices directly or indirectly involved in production. The "expenses" are the sums of money that have to be paid for these efforts and sacrifices — he adds: "In other words, they are its [a good's] supply price." [1]

The relation between money "prices" and consumers' satisfactions or producers' "real costs" presents one of the greatest difficulties met by those who seek a causal explanation of economic life. Marshall does not evade this problem. He presents some solution of it. It must be admitted, however, that in this case he unduly simplifies things (aided by his assumption that money has marginal utility) and lays himself open to criticism at points by treating "expenses" as the equivalent of "costs."

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[1] *Principles*, 4th ed., p. 418.

Distribution. — The idea of a balance or equilibrium between demand and supply, carries over into Marshall's theory of Distribution. He uses the marginal analysis comprehensively, applying it both to consumption goods and to agents of production. All values are interrelated through a process of "substitution" at margins of utilization of goods and services. In fact, he consistently treats distribution as a part of the valuation process. His explanation of normal price goes back, through "supply price," to the normal payments for the services of productive factors.

According to Marshall, that which is distributed is a sort of "National Dividend," which represents the annual net earnings of a nation. This "is divided up into earnings of labor; interest of capital; and lastly the producer's surplus, or rent of land and of other differential advantages for production. It constitutes the whole of them; and the larger it is, the larger, other things being equal, will be the share of each of them." [1]

Probably under the influence of English Classical economics, he may be said, on the whole, to consider that there are only three distinct factors of production: Labor, Land, and Capital. He seems to recognize the importance of "organization." He attributes a more distinctly important part to the entrepreneur than did his English predecessors, and treats him as the great means through which the principle of substitution is applied in the use of labor, land, and capital; yet it remains true that Marshall is inclined to reduce "enterprise" either to a species of labor (management) or to a form of differential advantage (securing a "quasi-rent").

In general, we are told that the "shares" in the "national dividend" depend upon the demand-and-supply forces as bearing upon the several factors of production. Demand is largely dependent upon the net product of the marginal increment of each factor. Supply, *in the long run,* is governed by the cost of production, except in the case of "land."

One of the more questionable devices used by Marshall should be mentioned here, namely his concept of a "representative firm." Such a firm is conceived of as one which, as others struggle into existence or decline toward failure, continues to charge prices which cover normal expenses, including management. These "representative" firms, therefore, seem to include all firms in an industry except those which are sub-marginal. But why not consider all the firms in an industry in a single series, with a single marginal firm or group? Why is the struggling new firm, or the old firm that is about to give up the struggle, not just "sub-marginal"? The significance of a representative firm lies in what it represents. Evidently Marshall thinks of efficiency, and considers all firms as falling into two great classes: the "representative," and the unrepresentative! Then why not treat laborers and capital instruments the same way?

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[1] *Principles*, p. 536.

After all, what does such a firm "represent"? Evidently some average conditions, modal or other. But an average implies a total situation, and, upon analysis, Marshall's total in this case seems to mean all firms which sell at or above cost, and thus make some "profit" (on their capital) *in the long run.* Thus one may ask, is he not begging his question by assuming that the general margin of production is a profitable one? At best, this device seems to be a mere identity between "normal" and "representative."

His thought does not need this device, and it may be that he adopted it because (1) in his short periods he found it difficult to relate his theory to cost, and (2) in his theory of "profits" he holds that this share is neither dependent upon business risks nor upon exertion.[1]

On the whole, and at bottom Marshall's theory of distribution is dominated by costs.

Take *wages*, for example. (1) He states that the normal wage is sufficient to enable a laborer, under normal conditions of employment, to support a normal family according to the normal standard of living. This suggests a standard-of-living theory. (2) He states that wages tend to equal the net product of labor; but he rightly adds that wages are not governed by the marginal product. (That product is just an incident to the marginal use of labor, governed by supply and demand.) For short periods only, do wages tend to follow the prices of goods produced. (3) He states that demand and supply exert a "coördinate influence" upon wages.[1] (4) But Marshall's thought is based upon "normal," or long-run tendencies, and he states that the constant tendency is for each "agent" of production (including labor) to get a sufficient reward for its "efforts and sacrifices." [2] *If conditions were stable*, this tendency would bring an adjustment between supply and demand such that laborers "would earn generally an amount that corresponded fairly with their cost of rearing and training," allowing for conventional necessaries.

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[1] See below, p. 648.

Apparently, therefore, only the assumption of constant change keeps Marshall from saying that wages tend to equal costs: (*a*) of rearing and training, (*b*) of living, and (*c*) of working.[3]

Marshall's *land rent* theory is essentially Ricardian, with a leaning toward Mill's alternative-use thought. But he broadens the rent concept by distinguishing "quasi-rents"; that is, temporary differentials arising from natural advantages possessed by any concrete agents of production.

Interest on capital is determined, immediately at least, by the equilibrium of demand and supply. The demand for capital derives from the gain anticipated from its use. The supply price is chiefly affected by the fact that most men prefer present gratifications to those which are deferred.

Capital goods, in concrete form, once they are made, may receive incomes which bear little relation to the cost of producing them. For short periods, the stock of such goods may be relatively fixed, and in this case, interest payments become "quasi-rents." In the long run, however, the supply becomes readjusted through replacements and substitutions, so that returns to capital tend to be equalized, and to conform to the costs of saving and waiting, these being the costs which attend the formation of capital.

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[1] *Principles*, p. 532.

[2] *Ibid.*, p 577.

[3] He seems to have dropped a statement to this effect, which appears on page 558 of the second edition. There he emphasized "expenses of production according to the ruling standard of comfort," and says demand plays no specific part. By the time of the 8th edition he stresses coördinate demand and supply.

Marshall's theory of *profits* is limited by his conception of the entrepreneur. It is based upon the old Classical doctrine, and attempts to follow the thought of the practical business man. Thus he thinks of the entrepreneur as a capitalist, and at the same time he calls profits "earnings of management." He figures profits as a return on "capital," either as an annual rate or as a rate on stock turnover; but he includes high salaried officials among those who exercise "management," and states that a fundamental unity underlies normal profits and normal wages.[1]

Marshall rejects a risk theory of profits, because it would tend "to class the work of management with mere routine superintendence."[2] Yet he recognizes that profits vary with prices, while the wage expenses lag behind prices. The element of business risk thus implied, he might possibly try to dismiss as pertaining to relatively short periods; but when he says that profits fluctuate with little relation to human exertion, while the reverse is true of wages, it is difficult to see how a fundamental unity between enterprise and labor can exist.

As to the theory of enterprise and profits, therefore, it seems fair to say that Marshall adds little. He tended to revert to English Classicism, a point to which further reference is made on page 653.

Surplus. — One notable feature of Marshall's thought is his development of the idea of the surplus. He includes not only land rent, as a surplus above cost, but also the vaguer ideas of "consumers' surplus" and "workers' surplus." The former appears to rest largely upon a psychological basis, and is briefly defined as the excess of the total utility of a commodity over the "real" value of what is paid for it.[1] The consumer of matches, salt, and newspapers enjoys or may enjoy such an excess. It might also be called a net benefit derived from fortunate surroundings or conjuncture. Workers' surplus, on the other hand, is the excess of remuneration coming from payments for total work made at the same rate paid for the last and most costly part, — with a deduction for the trouble of acquiring skill, etc.[2] Similarly, a savers' surplus is distinguished in the case of the capitalist. These surpluses, it will be observed, are not measured from the payments necessary to secure the coöperation of the factors of production, nor from the subsistence level; but depend upon sensibilities and their elasticity, and upon surroundings.

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[1] *Principles*, p. 623.

[2] *Ibid.*, p. 613.

Philosophy and Method. — Marshall's philosophy was certainly that of dualism. Throughout his work there stands out a belief in two great realities: man and material wealth. He sees man as having a character of his own, and he regards religious ideals as second only to everyday work and material resources as a factor in history. But he sees man as influenced by material resources.

Again, he sees innate differences among men which cannot be entirely eliminated, but he also states that poverty (lack of material means) is largely responsible for physical, mental, and moral weakness.[3]

Was Marshall an individualist in philosophy? Again we find a dualistic balance. To him, the individual is basic, but individuals can and do act as groups. He says that "the action of the whole is made up of its constituent parts; and that in most economic problems the best starting-point is to be found in the motives that affect the individual." He recognizes no social organism as the basis for a "social marginal utility." [4] But he also makes this strong statement: "The life of society is something more than the sum of the lives of its individual members." And the possibilities of collective action are emphasized. At times he refers to the "social organism."

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[1] *Principles*, 4th ed., pp. 124, 830.

[2] *Ibid.*, p. 830.

[3] *Ibid.*, p. 2.

[4] *Ibid.*, p. 25.

One may infer, it seems, that Marshall the economist accepted much of the materialistic-individualistic basis of Classical Economics; that Marshall the philosopher was a dualist; and that Marshall the man leaned toward idealism, and a considerable but limited amount of collective action.

The last statement is confirmed by his relatively great optimism. He inquires if poverty and ignorance may not be gradually extinguished, and states that economists have learned to take a hopeful view of the possibilities of human progress, since the will can modify circumstances, which in turn can modify character![1] (Let it not be forgotten, however, that he adds that it is the economist's duty to oppose plausible short-cuts toward such progress "which would sap the springs of energy and initiative.")

Traces of hedonism and reliance upon rational individual choices, are not lacking in Marshall's thought. This is clearest in his early editions, as he later sought to free his work of hedonism. There is implicit the idea of two opposing sets of desires: (*a*) desires for goods as a means of gratifying wants, and (*b*) desires to avoid efforts and sacrifices. He referred in his early editions to "the tendency of every one to select the best means of attaining his own ends," and in the eighth edition (p. 6) he speaks of "free choice by each individual of that line of conduct which after careful deliberation seems to him the best suited for attaining his ends." He assumes that economics deals with a "business part" of man's life, and that there are certain "motives which affect most powerfully and most steadily, man's conduct." But Marshall is far from considering that these are the whole of man. He states that wants often arise out of activities. He fully recognizes different grades or qualities of pleasure. He disavows the existence of the "economic man," and denies that motives or desires are *directly* measurable. He does not carry any philosophical hedonism that his thought may hold, into a system of ethics, and he deliberately tries to avoid all confusion of ethics with economics.

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[1] *Principles*, 4th ed., p. 48.

No economist who has attempted to construct a body of economic theory has been freer from unsound philosophical or psychological implications.

Although a skilled mathematician, it is significant to note that as an economist, Marshall was sceptical of mathematical methods.[1] His statement is that it is the business of economics to collect facts and to arrange and interpret them so as to draw inferences, thus reaching an explanation or a knowledge of causal relations. The chief use of pure mathematics, he finds, is to enable one to express one's own ideas concisely, and for one's own use. He doubts that it is worthwhile to read "lengthy translations of economic doctrines into mathematics."

Although he is painstaking in checking conclusions with the realities of life, his method is, on the whole, essentially abstract and deductive. He frankly and specifically abstracts those aspects of life into which money measurement enters.

Probably the outstanding aspect of Marshall's method is his sustained attempt to deal with the realities of life, including change, in such a way as to arrive at regularity, or "laws." Reference has been made to his "principle of continuity." By assuming gradual quantitative change as a basis for his thought — not qualitative changes, such as one in the relation between population and capital — he develops the concept of equilibrium as a "tendency." A frequently used device is that of first assuming a highly simplified condition, and then introducing complicating circumstances one after another, until something approaching reality is dealt with.

He deliberately and avowedly adopts a modified static (non-evolutionary) analysis, for the purpose of determining the nature of the forces at work, and the tendencies. Almost to the end, he appears to have hoped to make some final quantitative analysis of economic life based upon statistics.

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[1] *Principles*, p. 29, and Preface.

Criticism. — Marshall's exposition is so cautious and involved, and his attempts to qualify by making allowances for (1) different periods of time and (2) overlapping classifications of goods and services are so complex, that precise and unqualified criticism is not easy.

Despite his emphasis of law, however, it seems fair to say that he does not entirely succeed in adhering to cause-and-effect relations. In his quest for reality, he too often loses sight of scientific causality. In this respect, his well-known simile of the balls in a bowl, mutually determining one another's position, is typical. Ultimate causation we can hardly expect to grasp, but surely we can go back of balls and bowls to the force of gravity, inertia, etc. Determination can be finally treated only in terms of causation, and causation must "explain" how things come into existence. To treat each "cause" as a "result" and then make it a cause of another result may enable a more realistic description of events, but is hardly conducive to scientific explanation.

For example, Marshall develops a basis for the determination of value in causal terms. Some explanation of basic demand and supply schedules is presented. Why, then, should he fall back into the discussion of price-determined demands and supplies? Why should he write of demand or supply as consisting of quantities of goods bought or sold *at given prices?* Why should he, as a scientist seeking a fundamental determination of value, be concerned about the price-determined alternative uses of things, whether in treating of the relation of rent to price or other economic phenomena?

In this connection, one may ask, is there not a tendency to shift from a truly social point of view, cloaked by the tendency to distinguish between short periods and "the long run"? (And, again, Marshall's desire to seem "practical" and in touch with apparent realities would reënforce this tendency.) It seems that Marshall too frequently falls into an individual entrepreneur point of view, which is a short-term point of view that reckons little with long-run "tendencies" or "causes."

Hence his basing of prices upon prices and talk of laws of demand or of supply in terms of quantities at a price. Hence his readiness to pass from "real cost" to "money cost" or expense. Hence, too, his all too frequent reference to what should be regarded as "shares" in the net income of society, as "payments" made (presumably by business men) for the use of labor and capital. And, finally, this criticism suggests the explanation of his acceptance of an almost rudimentary treatment of the functions of the entrepreneur, after the fashion of the English Classical School. Marshall hardly recognizes "enterprise" as a distinct factor in production; although from a social point of view, profits, as distinguished from interest, presents a distinct problem of service valuation, and the size of a business enterprise may be a matter for consideration under the general law of diminishing returns and the principle of substitution.

Thus the following excerpts from his discussion of profits will seem confused to many: the motives of profit-seeking business men are "those which lead to the investment of capital and labor in building up the material plant and the organization of a business. . . . the price, that is expected as a reward for all this investment, is therefore a part of the normal expenses of production of the services rendered by it" (p. 619). What difference is there between capital, labor, and enterprise?

In treating "distribution" as being concerned with the *net* income of the nation,[1] he shows a tendency to take for granted or assume certain minima required for the subsistence, maintenance, and replacement of the nation's existing labor force, plant, and equipment. This assumption prevents a completely scientific treatment of the economics of value and distribution. It simplifies the problem of economic life, and doubtless it made Marshall feel more comfortable; but it involves the same shortcomings of all "marginal-productivity theory."

Another question, and a possible criticism, concerns Marshall's treatment of equilibrium as related to cost of production.

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[1] *Principles*, pp. 504, 523–524.

One would suppose that his dualistic approach and constant emphasis of demand and supply, would lead to a treatment of value as an equilibrium of coördinate forces. It would seem that cost would find an ample part as one element in "supply prices," and that "demand prices" would play a constant and coördinate part in determining all values. But, as we have seen, Marshall tells us that normal value coincides with cost, and all values (of produceable goods) tend toward the level of costs. It is as if he, after making use of marginal utility and demand prices in explaining short-period equilibria, then falls back upon cost to explain normal value. His synthesis of the marginal-utility theory and the cost theory seems incomplete.

Are costs not variable and subject to a problem of determination? Do they afford any causal explanation of the determination of value levels? Marshall's answer might be that costs vary less quickly than desires or other demand factors, but would that be an adequate reply?

In fact, does Marshall not make too absolute a separation between his long periods and his short periods? Does he not go too far in separating the two "kinds" of value, market value and normal value? Does he not lay himself open to the same criticism to which earlier economists are subject, namely that he treats different "cases" of value as if they were subject to different laws?

His idea of a "representative firm" appears as a device to bridge the gap between long and short periods, and savors of the question-begging use of averages which is all too characteristic of Classical Economics.[1]

It seems that he is again too much under the influence of a desire to be "practical," and to deal with the short-term actions of business men without keeping them subject to ultimate causal forces.

After all, Marshall's system must stand or fall according to the soundness of his theory of "normal" value. His economic theory proper is essentially static, and his dynamics deals with forces which must be considered as always tending toward an equilibrium which is normal. Otherwise, he would have two systems of economics, not adequately correlated.

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[1] E.g., see Adam Smith's reasoning as to labor and value above, pp. 221 f.

All this is connected with two other questions: one concerning his time periods, and the other concerning his demand and supply schedules. As to the former, one may ask whether it is possible to distinguish between long and short periods in the way Marshall does. Periods of time shade into one another, as he would be the first to recognize. They are relative, and their significance lies in what goes on during them. Causal explanation seems to be sacrificed when the criterion is made to depend upon time — except when "time preferences" are the point.

As to his "schedules," we note some inadequacy of analysis in the determination of subjective values, although this may be defended on the ground that economics may take for granted the conditions back of money offers. But Marshall at points treats "demand price" as the equivalent of marginal utility. This goes along with his idea that money has marginal utility — as if people want money for itself.

Similarly, he uses "supply price" in different senses: now it is a sum which a dealer is willing and able to take; now it is a sum of "expenses" incurred; again it is a sum required to induce efforts and sacrifices. Doubtless these things are interrelated; but they are not identical.

Clearly there is some confusion between utility as related to desire, and utility as related to satisfaction; similarly as to disutility as related to "real cost" and to resulting product.

Other questions might be raised, and some have been suggested in outlining his theories. But let it not be thought that the foregoing discussion is designed to belittle Marshall's achievements — who could do that?

Professor S. J. Chapman, one of Marshall's distinguished pupils, makes the following statement: "Marshall, for the first time, revealed the unity of the economic system, and presented it as a coherent whole of interrelated parts, functioning in mutual dependence upon one another. . . . We may notice among Marshall's additions to economics, the clear distinction between the long and the short period; the doctrine of consumer's surplus; the doctrine of quasi-rent; and the expansion of and refinement of the rent concept." [1]

Professor W. A. Scott, an adherent of the Austrian School, says: "He has demonstrated that the old doctrines of demand and supply, normal value, cost of production, etc., can be stated and interpreted in such a manner as to make them in some degree conform to the facts of modern life and to aid in their explanation. . . . Most of his reasoning and most of his conclusions have been, and doubtless will for a long time continue to be, accepted as sound by economists. . . . His treatise is authoritative, illuminating, and very valuable, but the most careful and profound students cannot but regard it as incomplete and unsatisfactory in its discussion of the most fundamental aspects of economic theory. His treatment of the interrelations and interactions of economic forces is masterly and unsurpassed, but there are problems in the science which require for their solution something more and different." [2]

Each "masterly and unsurpassed" system is in time surpassed by one which under changed conditions is more masterly; Marshall himself anticipated that time would cause much of his system to become obsolete. But we may say with certainty that his influence will never die, and that his reconstruction of economics made additions to the science which will become a permanent part of it. He enriched its terminology and its logical devices, as well as its laws. And his scholarly and scientific spirit, of which his effort to synthesize the theories of conflicting schools was one manifestation, did much to reëstablish the basis for a central body of economic principles upon which most economists can provisionally agree.

One of the greatest economists since Ricardo, he founded the school of Neo-Classical economics which predominated in England from 1890 until after his death in 1924, and which, though challenged by the followers of the Austrian School and J. B. Clark, exerted more influence upon American economic thought than any other prior to the period of World War I, depression, and Keynes. Alfred Marshall will stand in the history of economic thought as one who made more progress toward a united and consistent theory of value and distribution than any predecessor.

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[1] *Outlines of Pol. Econ.* (1917 ed.), pp. 450–451.

[2] *The Development of Economics* (1933), p. 473. Scott refers particularly to subjective value analysis and time preference in relation to "interest."

CHAPTER XXXIII

WICKSELL AND THE SWEDISH SCHOOL[1]

Knut Wicksell,[2] the great Swedish economist, not only became recognized as the founder of a "school" of economic theory, but has exercised such great influence on other economists that one may say, without him economics would be different.

Wicksell was born in 1851, studied philosophy and mathematics, and obtained his degree in 1885. Thereafter, he took up economics, studying in France, Germany, Austria, and England. Returning to Sweden, he was made assistant professor at Lund in 1900, and there he occupied the chair of economics from 1904 to 1916. He died in 1926.

He wrote many articles for Swedish publications, and some for German and English journals. But his main work is concentrated in five volumes published in German between 1893 and 1906.[3] The English translation of his *Lectures on Political Economy* (1934 and 1935) contains his most important thought. It is necessary only to add the article on "The Influence of the Rate of Interest on Prices," *Economic Journal*, 1907.

Conditions and Antecedents. — First it is to be observed that Wicksell's thought was greatly influenced by the long decline in prices and discount rates during the period 1873–1895, and the discussions which accompanied them. Probably it is fair to say that his thought had matured by 1898 when his *Interest and Prices* appeared. Thus he dwelt upon price *movements,* secular and cyclical, and tended to emphasize the part played by credit. He is a pioneer in coördinating theories of price and of interest with a theory of the value of money.

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[1] See below, pp. 790 ff.

[2] On Wicksell, see Ohlin, B., "Some Notes on the Stockholm Theory of Savings and Investment," *Econ. Jr.*, 1937; Robbins, L., Introduction to Wicksell's *Lectures on Political Economy*, Vol. I; Gide-Rist, *A History of Economic Doctrines*, 2d Eng. ed., pp. 725–731; Ellis (ed.), *A Survey of Contemporary Economics*, Index.

[3] *Über Wert, Kapital und Rente* (Value, Capital and Rent), 1893; *Finanztheoretische Untersuchungen* (Studies in Finance Theory), 1896; *Geldzins und Güterpreise* (Interest and Prices), 1898; *Vorlesungen über Nationalökonomie* (Lectures on Political Economy), 2 volumes, 1901 and 1906. *Interest and Prices* and *Lectures* are available in English translations.

In Wicksell's background was a wide acquaintance with, and good understanding of, Classical Economics. The main influence on his thought, however, came from two sources: the Austrian School, particularly Böhm-Bawerk, and L. Walras. Other factors in his thought were the English economists, Wicksteed and Edgeworth, and through Wicksteed he was influenced by Pareto. Wicksell also cites Marshall occasionally.

Thus there was in this Swedish economist a good deal of the Classical and Neo-Classical thought. This appears in some attention given to production, and in the importance attached to "real" capital and to the barter aspect of exchanges. He also attached great importance to population, and was even imprisoned for a short time because of his views on this subject.

But for the most part, he deals with economic life in terms of marginal utility, and he makes large use of the mathematical equations upon which Walras depended. Wicksell sought to synthesize the marginal productivity analysis of the Austrian School and the general price equilibrium theory of the Lausanne School — the theory that all prices are so mutually interdependent that price problems can be solved by a mathematical process of simultaneous equations.

Wicksell's Main Theories. — Wicksell correlated his theories of value and of distribution, so that it may be said that marginal productivity occupies the center of his system: "It governs every part of the political economy." His general marginal-productivity theory, he applies under the condition of such employment of all the factors of production that no economies from a larger-scale of production are possible. (Thus he considers only economically productive employment, and so avoids the problem of an equilibrium at less than full employment.)

The main part of his thought, however, as judged by its influence, is the theory of capital and interest. From this, springs Wicksell's famous treatment of money rates as related to the "natural" rate of interest, and the bearing of this relation on the general price level.

Capital is defined as a "coherent mass of stored-up labor and saved-up land." And the importance of the time element is duly recognized. Indeed, Wicksell considers the mass of capital as stratified through time, and this leads him at once into a sort of "period analysis." Along with the labor and land of one year, there function the saved-up resources [capital goods] of the preceding year. These capital goods, he assumes to be used up in the production of the current year. Therefore, he assumes that, in order to obtain the advantages of capital use, a corresponding part of the current year's resources must be saved up for the next year's capital. And so on. Thus we see the problem of saving beginning to emerge.

Interest, in its pure form, is the "marginal productivity of waiting." Time is its essence. More precisely, Wicksell defines interest (and thereby states his theory of interest) as follows: It is the *difference* between (1) the marginal productivity of saved-up labor and land, and (2) the marginal productivity of currently-used labor and land. This difference is not a mere function of time or waiting, however, for he says that current labor and land are relatively abundant, while saved-up labor and land are "not adequate in the same degree for the many purposes in which they have an advantage."[1]

Wicksell thinks that interest may disappear if the foregoing "difference" disappears, but that this is unlikely: before interest could fall to zero, the problem of investing for a longer period than the next year would arise. In other words, declining rates will be attended by a longer investment period and increased capital values, thus tending to counteract the declining spread between current and future goods. But this general thought suggests the idea of secular stagnation.

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[1] *Lectures*, Vol. I, p. 155.

At various points, he states that rising interest rates stimulate saving, and that low rates discourage saving.

Interest and Prices. — This brings us to his famous theory as to the relation of interest to prices, and the "cumulative process."

The central point in this theory is the doctrine that there is a "natural" rate of interest, and a bank rate or money rate which will be here called the market rate; and that the relation between these two rates is of great importance. The "natural" rate is one that equalizes saving and investment. It tends to equal the *expected* yield on newly created capital goods. It is virtually Böhm-Bawerk's marginal productivity of capital. It is relatively stable. The market rate on money loans or credit is merely the price of money determined according to the Walras formula in combination with other scarce goods in a single system of simultaneous equations. It tends to equal the "natural" rate, but may be above or below it.

If the market rate be *relatively* low, (1) saving is discouraged, (2) consumption tends to rise, and enterprisers tend to see profit opportunities, (3) investment is stimulated, (4) prices rise. If, however, the market rate be above the natural rate, enterprisers lose, business declines, and prices fall. These conditions often appear in reality, and unless one be alert to consider that they may be results of a common cause, they may suggest that by manipulating the market rate, one can control price levels. Hesitatingly, and while still defending the quantity theory, Wicksell adopts this suggestion, saying that the market rate may be kept below the natural rate, and prices be kept rising, as long as the supply of loanable funds is supplemented by creating credit, or by dishoarding.

Savings and Investment. — So we come to the difference between saving money and investing it, considered as a disturbing factor. Under the influence of the Walrasian timeless system, Wicksell thought it strange that when prices fall, the fall does not merely release purchasing power and thus bring a counteracting increase in effective demand. He assumes that the spending of one individual is the income of another, so that the *aggregate* purchasing power remains the same. In this connection, no allowance is made for time lags.

With this approach, he assumes that "normal" means a condition in which (1) Income = Spending, and in which (2) all income not spent for consumption is spent for capital (invested). Such a condition, he thinks, would mean a *constant price level*, so that, in the last analysis, this is his criterion of normality.

Then he goes on to suggest that departures from normal arise from inequality between voluntary saving and investment. Consumption depends upon the part of their incomes which people want to consume; but investment does not depend on mere voluntary saving. The decisions to save and invest are made by different people. So saving may increase beyond investment, and then income is reduced, consumption declines, and prices fall.

But Wicksell suggests that this process can be controlled by means of the bank discount rate. The market rate can be maintained below the natural rate. This would stimulate investment. Prices would then rise, till finally the market rate rises. Such is the celebrated "cumulative process."[1]

Influence. — Wicksell's influence increased with time. In the first place, his thought was developed by a "school" of Swedish economists. Myrdal in 1927 emphasized the uncertainty of the future as a factor in prices — the "anticipation" factor. Lindahl in 1930 applied the Wicksellian technique to the problem of employment, and made further progress toward a "period analysis." These men and their followers did not on the whole accept Wicksell's idea of using interest rates as controls. And they moved away from the concept of a timeless equilibrium toward a more truly dynamic concept. But they developed the idea of equilibrium over time periods with emphasis on saving and investment.

In the second place, Wicksell was widely read in central Europe and Italy. He was well known to, and influenced the thought of, Hayek, Keynes, and Hicks. To one living in the middle of the twentieth century, what more need be said!

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[1] *Interest and Prices*, p. 120.

The Criticism. — In criticism of Wicksell's thought, it is first to be noted that he hardly succeeded in synthesizing the timeless ("simultaneous") economics of Walras with the timeful (roundabout) economics of Böhm-Bawerk. On the whole, he leans toward the timeless mathematics of Walras, in his premises concerning normality and the mutual determination of prices. But his "natural" interest is based on time differences, and in his application he introduces inconsistent lags in time, as between savings and investment.

More concretely, he held that a market money rate which clears the market of voluntarily accumulated funds keeps prices stable. But (1) this fails to allow for conditions of supply, such as risk and the stream of savings; and (2) it does not allow for time, and the differences in interest rates which exist on loans for different periods of time and different degrees of uncertainty.

In general, Wicksell shows the weakness of "price economics." His margins are often price-determined. He virtually assumes the existence of capital, and falls back on opportunity cost — the opportunity of the lender to use his own funds. He treats interest as a price which *affects* other prices, and so may be treated as a *cause*, rather than as a result. He shifts from a study of the cause and determination of interest, to the manipulation of interest rates to control prices. Thus he is led into the error of assuming that the processes which occur when voluntary choices in saving and investing govern interest rates can be reversed; that manipulated interest rates can be used to govern choices in saving and investing. This has been disproved by the repeated failure of open market operations of central banks during the great depression of the thirties.

And, finally, the logical outcome of such economics appears in the omission of the entrepreneur and profits, *as distinct from capital and interest.* Wicksell even criticizes Marshall for trying to set up "management" as a distinct factor of production.

Final Appraisal. — But Knut Wicksell was a first rate economist. He was eclectic; but only in the best sense, and shows masterly ability in synthesis, resembling Marshall in this respect. In a word, he was a true scientist, and showed his power by creating a general system of economic theory that is consistent enough to have resulted in a vigorous school of thought.

Not the least important result of Wicksell's thought was its influence on J. M. Keynes, some of whose basic ideas appear to have come directly from the Swedish professor. But let it be remembered that Wicksell himself sought no "revolution" in economic theory or terminology. Nor did he abandon the work of his predecessors. This is seen, in his basic theory, in his emphasis on population and on time. He gives attention to technological progress and population growth in his treatment of crises. His concept of "equilibrium" is the scientific one of a balance between demand and supply forces in which economic friction plays a part. He hesitated to apply his idea of using the interest rate as a control, and his "school" has dropped that idea.

Wicksell at bottom was a true scientist.

VII. CRITICS OF NEO-CLASSICISM

If Alfred Marshall and the Cambridge School, together with the leading members of the Austrian School and, in good part, Knut Wicksell, may be thought of as Neo-Classical, carrying on in the Classical tradition of economic science, then obviously Neo-Classicism has been subject to a great deal of criticism and attack much as was Classicism before it. Of course, various forms of Socialism and Nationalism have continued throughout the period under consideration, and have criticized Neo-Classicism. Their general line of attack has been made sufficiently clear in discussing the attitude of earlier Socialists toward the Classical school. Therefore, there are considered here only those economists who, not being collectivists, attempted to revise Neo-Classical thought in a sweeping way or to replace it by a body of economic doctrine based on a different philosophy.

The development of business cycle theory has not necessarily been hostile to Neo-Classical economics. Indeed, an important part in the development of such theory has been played by Neo-Classicists. The acceptance of cycle theory, however, has required important changes in the Neo-Classical treatment of economics, and the radical tendency to emphasize consumption has been closely associated with underconsumption theories of the cycle. The other theories presented under the head of "critics of Neo-Classicism" all clearly have in common the element of attack upon some vital part of the Neo-Classical doctrine. Mostly they attack the importance of free individual choices as the basis for a theory of value and distribution, and suggest in varying degrees the desirability of direct social action. As will appear in Chapter XXXVIII, in the case of general-equilibrium theory the essential point of attack lies in the criticism of marginal utility and in the proposal to substitute therefor the idea of indifference.

CHAPTER XXXIV

THE DEVELOPMENT OF BUSINESS CYCLE THEORY[1]

In a general way, all cycle theories involve some maladjustment, and all may be classed as (1) overproduction-type or (2) underconsumption-type theories. Some would go back of the overproduction or underconsumption, seeking the *cause* in (a) human motivation, or in (b) environmental conditions, perhaps distinguishing (c) the institutional environment (e.g., property rights). But for the purposes of ready classification, the attitude of the economist toward the primary importance of production or consumption is to be emphasized. Those who regard production as preceding consumption and limiting it tend toward overproduction theories of various types. The economist who thinks that consumption comes before production and limits production tends to adopt some form of underconsumption theory.

The overproduction-type theories may emphasize consumer goods, capital goods, or investment of money or credit. They may stress fixed capital as against circulating or liquid capital. In each case, the overproduction may be more or less general, and may be merely a "maladjustment." Just so, the underconsumption theories differ in scope. Some underconsumptionists hold crises to be caused by unequal incomes, others by inadequate total supply of money or credit. These, in turn, they may attribute either to exploitation, to oversaving, or to underinvestment.

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[1] See Haberler, G. von, *Prosperity and Depression*, 3d Eng. ed., 1941; Gide-Rist, *A History of Economic Doctrines*, 2d Eng. ed., 1948 (7th French ed.), Bk. VI, Chap. 2; Estey, J. A., *Business Cycles*, 1941; *Readings in Business Cycle Theory*, Blakiston Co., 1944; Mitchell, W. C., *Business Cycles, the Problem and Its Setting*, 1927; Fellner, W., "Employment Theory and Business Cycles" in *A Survey of Contemporary Economics* (Ellis, H. S., ed.), 1948; Hayek, F. A., *Monetary Theory and the Trade Cycle*, 1934; Wagemann, E., *Economic Rhythm*, 1930.

From the earliest times, come comments on lean or bad years, and fat or good years. But only with the development of an exchange economy, was there any suggestion of recurring periods of general prosperity and depression which could be regarded as a social phenomenon and as an economic problem. In the fifteenth century, a money and exchange economy developed, and by the sixteenth century, the Mercantilist writers began to show some interest in the problem of general prosperity and depression, including the problem of occasional general unemployment.

The Mercantilists, however, did not think of these conditions as being regularly recurrent or cyclical. Mostly, they thought of prosperity as a condition to be attained by certain policies, and then to be sustained. They treated hard times as conditions to be prevented by the same policies.

The policies most favored by them concerned money and interest rates. Mun, Petty, Child, Locke, and Misselden all expressed opinions on these subjects.[1] The prevalent opinion was that increasing the quantity of money, or low interest rates, or both, tended to make a nation prosperous. Toward the end of the Mercantilist period, John Law, whose thought has been likened to that of J. M. Keynes,[2] developed a theory of prosperity which rested on the abundance of credit currency, and actually succeeded in causing a short-lived boom in debt-ridden France.[3]

Throughout the Mercantilist centuries, the general idea was that business can be made good by a plentiful supply of money, and that low money rates are a sign, and probably a cause of, prosperity. There was even some mention of the importance of a favorable relation between the bank rate of interest and the yield on invested capital; but not much scope was given to this idea, in view of the slight development of bank credit. No theory of "cycles" existed.

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[1] See above, pp. 126, 132–134.

[2] See Wilson, E. B., "John Law and John Keynes," *Quart. Jr. Econ.*, May 1948, p. 15 ff.

[3] See above, p. 126.

I. Early Classical Period: "Crises"

Overproduction. — Nor did the development of the Classical Political Economy in the second half of the eighteenth century lead to cycle theory. The Classical economist considered conditions of temporary overproduction, at least in some industries, as requiring periods of readjustment. By Ricardo's time, the phenomenon of a war boom and ensuing depression was well known to them, and Ricardo himself discusses "revulsions in trade," caused by changes in the channels of trade which require shifts in invested capital, and pointed out the importance of the proportion of fixed and circulating capital in this respect.[1] It may be said that the early Classical thought suggests what may be called a *partial overproduction theory* of business recessions. But the early Classicists had no cycle statistics or records to study. Above all, they were engrossed in developing a static theory of value and distribution, based on long-run tendencies. To most of them, Say's Law seemed to absolve the economist from the need of devoting much attention to "trade revulsions."

Underconsumption. — Malthus, however, was different in several respects, and his theory of population led him very early in the nineteenth century to state a sort of real cycle theory based on an oscillation in the relation between population and food, around an equilibrium in which subsistence just provides support for a stationary population.[2] Moreover, Malthus took the side of those who, in criticism of the accepted Classical doctrine, held that a "general glut" is possible. He laid more emphasis on consumption and demand than Ricardo did.

In the acceptance of general overproduction and the emphasis of consumption, the lead was taken by Sismondi and the early Socialist critics of Classical economics, as set forth in earlier chapters. Sismondi, with a background of circular-flow theory and macro-economics (one that deals with aggregate totals for a society), presented an underconsumption theory of crises, supported by a "period analysis" of income and production. (He criticized the economists for confusing the revenue of one period with that of another.) He starts with total national income, and makes crises depend on its failure to keep sufficient to buy total output. But back of that, Sismondi saw an unequal distribution of wealth, resulting in low incomes for the mass of laborers. Property, not wants, governs production, and this results in a tendency of consumption to lag.

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[1] *Political Economy*, Chap. XIX.

[2] See above, p. 269.

The theories of the early Socialists led up to that of Rodbertus which may be taken as representing their best thought. As early as 1837, he presented the idea of a declining wage share, caused by the exploitation of labor by property owners. The proportion of the national income received by the mass of laborers diminishes, and purchasing power thus fails to keep pace with output.[1] These are crisis theories based on underconsumption. They do not attempt to explain cycles as periodic phenomena.

Summary. — Thus it seems fair to say that, down to about the middle of the nineteenth century, no comprehensive theory of regularly recurring business cycles was developed. The theory concerned *occasional* movements. Moreover, it dealt mostly with depressions, or crises, as "trade revulsions." Evidence was largely drawn from periods of hard times. The main characteristics of the thought of the period were: (1) *Overproduction* theories among the orthodox Classicists, based largely on friction in adjustments to occasional disturbances such as wars and crop variations; (2) *Underconsumption* theories among the critics, Socialists and others, based mainly on unequal distribution of income.

It is to be noted that the foregoing theories center on production and consumption of *finished goods* or products. And any theory of money is kept separate from value theory.

II. THE "CAPITALIST AGE": "CYCLES"

A. CAPITAL GOODS THEORIES

By the middle of the nineteenth century, the Industrial Revolution had been consummated, and the emphasis in the economists' theories of prosperity and depression came to center on capital goods, particularly the large masses of fixed capital.

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[1] See above, p. 482. Marx in general follows Rodbertus.

Also the extensive use of the joint-stock limited liability form of business organization brought new problems of saving, investment, and speculation. And the greater part played by bank credit is to be noted. But, under the influence of early troubles with bank credit, the British "Currency School" developed in support of the idea that only coin and notes representing metal are money; and accordingly the Bank Act of 1844 was passed. Thus, for a while, there was some tendency to pay little attention to bank credit, or to interest rates as affecting the use of such credit. This encouraged non-monetary cycle theory.

Moreover, the Classical doctrine that economics is basically a matter of "real" wealth and of exchanging goods for goods still prevailed. Add the further ideas (1) that economics is mainly concerned with the long run, and (2) that not only does saving lead to consumption, but also savings of money tend to equal investment, and the character of the period's main thought about cycles is readily understood.

Finally, a series of cycles in business activity had been observed, and statistical data had been accumulated. Thus a basis for cycle theory was laid.

The outstanding developments were the theory of periodic business cycles, and the theory that such cycles are a result of the overproduction of capital goods.

1. The "Cycle." — It would be difficult to say when the idea of periodic swings called cycles first occurred. It is often attributed to the Frenchman, Clement Juglar, whose *Des Crises Commerciales* appeared in 1860. He developed the thesis that regularly recurring and interrelated periods of expansion and contraction occur in business. But as early as 1848, John Stuart Mill in his *Political Economy* said: "The frequent recurrence during the last half century of the painful series of phenomena called a commercial crisis" had led to various explanations and attempts to mitigate them.[1] He refers to the "almost periodic recurrence" of fits of speculation.[1] Thus there must have been a fairly widespread consideration of cycle periodicity.

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[1] Ashley ed., p. 651.

W. S. Jevons, after early studies of "periodic commercial fluctuations" (1862) and applying index numbers to measure fluctuations in the price of gold (1863 and 1869), finally contributed to this tendency by advancing the hypothesis that sunspot cycles so affect conditions on the earth as to cause rhythmical fluctuations in business activity. He made statistical studies showing that the average period of English trade cycles had been closely similar to the average period of the sunspot cycle, at about 10.5 years.

2. Overproduction of Capital Goods. — But the prevalent tendency was to seek the cause of cycles in variations in production, particularly in the production of capital goods, or in variations in saving regarded as invested in capital goods, with considerable incidental attention to the part played by money and credit. This type of cycle theory is illustrated by J. S. Mill and by A. Spiethoff.

Mill's thought is important because of his position as the leading Classical economist of this period. Rejecting the monetary theories of the "currency theorists," Mill, in a brief and somewhat fragmentary way, presents the following theory: Two states of business exist, one a state of ordinary stability, and one an "expectant, or speculative state." The latter arises through supplies of some goods being less than demand, thus leading to speculative activities for profit. Credit is extended, and credit currency thus affects prices, which rise. The interest rate rises "inordinately," leading to a crisis. Then comes the "revulsion," with failures and bankruptcies. Funds then accumulate and interest rates are low, presumably pending another speculative state.

The essential nature of this cycle is clearly shown in the addition Mill makes in the 1865 revision. Here he emphasizes the varying proportions between "interest receiving capitalists" and "profit receiving capitalists." The former make loans to the latter, who invest them in business capital. These "speculative" loans to "profit-receiving capitalists" become overexpanded and lead to urgent demands for loans for mere monetary purposes, to repay debts. This, Mill thinks, together with the resulting rise in interest, is "one of the earliest features of commercial crises." In short, too much money is tied up in capital goods, and the demand for credit becomes too great.[1]

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[1] Ashley ed., p. 641.

Arthur Spiethoff[2] (1873–1938), influenced by his father's failure in Westphalia in the crisis of 1873, undertook an extensive and prolonged historical research into business cycles, his theory being completed only after the crisis of 1890. He studied with Schmoller and Wagner in Berlin, and read Juglar and Tugan-Baranowsky (a Russian economist who early explained crises as fluctuations in savings as affecting investment by enterprisers[3]). The result was what has been called a "non-monetary over-investment theory," that is, one which centers on overproduction of capital goods.

Spiethoff's idea is that cyclical movements are characterized by a relative overproduction of capital goods, and a relative underproduction of consumer goods. The upswing starts from a condition of idle capital and low interest and wage rates, with bank rates below investment yields. "Bold men" see opportunities in extending markets and technological development. Once started, there is a "circular flow of expansive facts," the main factor being the rise in prices of producers' goods and an increased *rate* of investment. At length, a difference between "acquisitive capital" and "productive capital," which amounts to an overproduction of capital goods, arises. The relative shortage of what Spiethoff variously calls monetary capital, complementary goods, or acquisitive capital (and which seems much like Mill's idea of loans to "profit-receiving capitalists") finally brings a crisis.

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[1] *Ibid.*, Chapters on "Rate of Interest" and on "Regulation of Convertible Paper Currency."

[2] See Schweitzer, A., "Spiethoff's Theory of the Business Cycle," U. of Wyoming Pubs. VIII, no. 1, pp. 1–30 (1941); Spiethoff's theory is found in articles on overproduction, crisis, etc. in *Schmoller's Jahrbuecher fuer Gesetzgebung, Verwaltung, etc.*, 1902, 1903, 1909, 1918; and the article on "Krisen" in *Handwoerterbuch der Staatswissenschaften*, 4th ed. 1925.

[3] *Les Crises Industrielles en Angleterre*, 1913.

His influence was considerable, the cycle theories of both Wicksell and Cassel being modeled on his.

Of the foregoing theories, the following summary observations may be made:

They accepted the existence of periodic cycles.

They emphasized the overproduction of fixed capital, resulting from the accumulation of savings and investment in capital goods.

Cycles, they said, are not attributable to money, and monetary remedies are futile. It is particularly to be noted that they tacitly accept the position of the "currency principle," in that they do not consider the expansion of credit currency as a causal factor.

They imply that the abundance of savings, and low interest rates, which come after recessions, have something to do with following expansions.

They clearly suggest a principle of acceleration.

In general criticism, one may say that these cycle theories had little relation to the general economic theory. It is also notable that little attention was paid to income or consumption as a cause.

3. Underconsumption due to Capitalist Practices. — During this period of cycle theory, the logical counterpart of the theory of overproduction of capital goods would be a theory of general underconsumption caused by the *use of savings to make capital goods*. Such a theory may be called oversaving in the sense of *not-consuming*. Or it may be called a non-monetary theory of oversaving. Such a theory stands opposed to the Classical tendency to emphasize production (or overproduction), and it tends to conflict with the Classical assumption that saving is associated with production of capital goods and is therefore desirable.

Probably the theories of Marx and his Communist followers are to be classed here. Marx held that crises are periodic violent solutions of conflicts that are inherent in "the capitalist system." These conflicts arise in three main ways: (1) the accumulation of capital, (2) the increase in the proportion of fixed capital, and (3) the decline in the rate of interest ("profits"). The accumulation of capital, and particularly the increased proportion of fixed capital, results in a decline in the consuming power of society. So, as capitalists "exploit" labor and apply their ill-gotten gains (which they call savings!) to increased production, they are destroying their own market by reducing "wage capital," the consuming power of laborers. Crises temporarily restore equilibrium between production and consumption.[1]

Passing over the post-Marxian literature, we may well close this period of cycle theory with a brief statement of the views of John A. Hobson, as set forth near the end of the nineteenth century.[2] Hobson's theory is that the cause of cycles lies in underconsumption, which develops because of the excessive or undue application of savings to capital goods. The real responsibility for trade depressions, he says, rests with consumers, the "root evil" being underconsumption. He argues that the desire to consume must be considered as a desire to consume *now*, and as existing *continuously*, in proportion to available purchasing power. This condition is disturbed by the desire to postpone consumption, or saving, which he sometimes refers to as the habit of saving. Those who are able to consume (what they could produce) are not willing to do so: they save.

Thus Hobson defines saving as "not-consuming," in the sense of not using up consumer goods. And, from an aggregate social point of view, he asserts that all saving necessarily means investment in capital goods. (It makes no difference, he thinks, whether these be fixed or circulating.) "Saving," to him, does not include mere transfers of funds by one individual to another individual. It is not mere abstention from spending on consumer goods. It necessarily means producing any sort of future goods, which are not consumed at once.

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[1] On Marxian theory of crisis cf. Dobb, M., *Political Economy and Capitalism*, 1940. For Marx's ideas see *Das Kapital*, Vol. III, part i, especially pp. 191–212, 225–226, 542–562.

[2] In *Physiology of Industry* (1889) and in *Evolution of Modern Capitalism, a Study of Machine Production*, 2d ed. 1901, pp. 174–219.

Thus oversaving, as Hobson uses the term, is a social phenomenon. It could hardly exist outside our "complex industrial society," in which every act of *real* saving signifies making, or causing to be made, forms of capital goods.

In brief summary: The non-monetary underconsumption theory of the second half of the nineteenth century, as typified by Marx and Hobson, tends to explain periodic cycles as *part of a continuous tendency to disequilibrium.* Such a tendency is associated with capital and the institutions of capitalist society.

The continuous cause of economic disequilibrium is found in a tendency of total consumption to lag behind total production, either because of exploitation or of a desire to postpone consumption and accumulate future goods. ("Saving" is thus either robbery or a bad habit.)

Thus the tendency is to advocate more or less sweeping changes in social institutions.

The problems of time and of interest rates are slighted or evaded. Some emphasize property rights in "fixed capital"; others ignore the difference between time periods. And enterprise, as distinct from capital, is disregarded, so that "business confidence" is hardly a factor.

B. INVESTMENT THEORIES

Roughly speaking, one may say that from the 1890's on the financial aspect of economic life became more prominent, and that the cycle theories originating thereafter were generally financial theories. Some of these attribute cycles to overinvestment, others to underinvestment; but all center in investment — the use of funds.

This condition was associated with a great development of central banking and a use of credit on a nation-wide and international scale. And at the same time, the phenomena of corporation finance, mergers, holding companies, and cartels became prominent together with speculation on security markets.

Money having an objective value related to some standard material was generally accepted as desirable. But the way for experiments with credit currency was being prepared by the extended use of credit in business, and finally by the financing of World War I.

The recurrent cyclical recessions of 1873, 1884, 1893, 1904, and 1907 were followed by the war depression of 1914, the war boom, and the primary post-war depression of 1921, thus providing fresh data. These were compiled and analyzed by various scholars in the United States[1] and Europe,[2] and important work in statistical theory was applied in analyzing time series.[3] In the twenties, "Bureaus" and "Institutes" for research in statistics and cycles sprang up in most of the leading nations.

Thus the time was ripe for a new crop of cycle theories.

And this is the more true, because of the decline in Classical economics. Its ascendency ended with Mill. Then, after a short interval, came the rise of the Austrian School and the Neo-Classical school of Marshall. Of these, the former had more immediate effect on the cycle theory. The conscious and direct opposition of the Austrian School to Socialism, and their development of a theory of the value of money based on marginal utility were factors in the new cycle theory. In the latter point, Marshall's treatment of money as having marginal utility reinforced the Austrian tendency.

1. The Principle of Acceleration. — One of the earliest developments to be mentioned here is the idea of "acceleration" and the "acceleration of derived demand." Although many early suggestions of the idea are to be found, the first to state it fully and in relation to the cycle theory appears to be T. N. Carver,[4] and later Aftalion and J. M. Clark.[5]

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[1] E.g., O. M. W. Sprague (*Crises under the Nat'l. Banking System*, 1910), W. C. Mitchell, W. M. Persons.

[2] E.g., Spiethoff, Tugan-Baranowsky, Kondratief, Wagemann, Hayek, and others.

[3] H. L. Moore, Irving Fisher, W. M. Persons, and many others.

[4] "A Suggestion for a Theory of Industrial Depression," *Quart. Jr. Econ.*, May 1903; *Principles of National Economy*, 1921, pp. 436–440.

[5] "Business Acceleration and the Law of Demand," *Jr. Pol. Econ.*, March 1917.

Carver pointed out that a slight change in consumer goods prices may have a large effect on producers' goods, and that the value of producers' goods tends to fluctuate much more violently than the value of consumers' goods. Clark discusses the multiplied effects of a change in demand for products upon the means of production, emphasizing the point that the supply of the latter cannot be adjusted as rapidly as the demand changes. Both refer to the accelerating effects of buyers' anticipations of such results.

2. Partial Overinvestment Theories, Non-Monetary.[1] — Following Spiethoff, four economists who developed important cycle theories should be mentioned: Aftalion, Pigou,[2] Schumpeter, and Robertson. There are considerable differences among their theories, but they have certain common features. They tend to center on some kind of overproduction resulting from overinvestment. They emphasize the part played by the enterpriser. The period of the cycle is connected with the time required to make new equipment or processes effective. They are all rather eclectic in the best sense of that term. All integrate cycle theory with general theory.

It may further be said that the four, while including money and credit phenomena, present essentially non-monetary theories of cycle causation, though this is less true of Robertson.

The French economist, A. Aftalion (1874–1939) presented in 1911 a well worked out theory of cycles consisting in production rhythm.[3] Supply varies relatively to wants. Once expansion begins in the instruments of production, it carries on till the flow of consumer goods causes reduced marginal utility, the desire factor in demand. The crisis proper is occasioned by a breakdown in demand and prices. Thus recurrent periods of overproduction occur, in the sense that the demand for goods is not sufficiently intense to allow profitable prices.

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[1] The author's theory of cycles more closely resembles this group than any other, and has several features in common with the theories of Schumpeter and Robertson. In my *Business Forecasting*, 1931, I distinguished active and passive conditions, causing departures from equilibrium which are periodic in character; emphasize the "boom" phase, classifying the characteristic maladjustments under the heads of industrial and financial; and finally integrate my cycle theory with value theory in a theory of the P/V ratio. See also my chapter on "Business Cycles" in Spahr (and others), *Economic Principles and Problems* (4th ed. 1940), Vol. II, Chap. XXXII.

[2] *Wealth and Welfare*, 1912; *The Economics of Welfare*, 1920 (4th ed. 1932); *The Political Economy of War*, 1921; *Industrial Fluctuations*, 1927; "Monetary Theory of Crises," *Econ. Jr.*, 1929; *Socialism vs. Capitalism*, 1937.

[3] *Les Crises Périodiques de Surproduction*, 1911.

The Cambridge professor, A. C. Pigou (b. 1877), holds that the real causes of cycles are complex, including crop variations, inventions and improvements in production, new natural resources, and changes in tastes and desires. He emphasizes psychological factors, particularly the tendency of enterprisers to develop mass waves of optimism.

J. A. Schumpeter (b. 1883), the Austrian-born Harvard professor, has developed a notable theory centering on the action of enterprisers as a dynamic factor which disturbs economic equilibrium.[1] The entrepreneur, in quest of profits, makes innovations in business. He induces bankers to extend credit, bidding up interest rates, and pays higher wages to divert labor. Wages and prices rise. This tends to reduce profits. Finally, the products of this innovation appear on the market, and the enterpriser pays off his loans. The volume of purchasing power is thus reduced. A period of confusion and uncertainty results, during which further innovation is discouraged. Thus the expansion period of the cycle depends largely upon the time required to install the new equipment or methods. Booms are emphasized, depression apparently being considered unnecessary.

Schumpeter's theory makes cycles depend upon dynamic conditions in which increased productivity is anticipated, so that interest can be earned. In a condition of static equilibrium, the saving and investment of the past are equal to the consumption of the present, so that no costs of waiting or time lags are felt, and no interest is thought to be required. His thought here shows considerable influence by the Walrasian school of general equilibrium.

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[1] *Theory of Economic Development*, 1934 (Ger. ed. 1912); "The Explanation of Business Cycles," *Economica*, 1927; *Business Cycles*, 2 vols. 1938; *Capitalism, Socialism and Democracy*, 1942.

The Cambridge economist, D. H. Robertson[1] (b. 1890), began as a follower of Marshall, but came to lean more toward the monetary theories of the Keynesian group. He states that the real causes of cycles lie in changes in real costs, and in demand. The characteristic part of his cycle theory is "discontinuous change," associated with "inappropriate responses" or maladjustments. Enterprisers are optimistic. They act with discontinuous spurts, making an irregular demand for capital goods. The duration of the cycle depends chiefly upon the "gestation period" required to make investments effective.

But Robertson came to stress monetary influences and to hold a loanable-funds theory of interest. Thus, despite the breadth of his analysis and his criticism not only of the crude underconsumption theories of Foster and Catchings but also of Keynes, he pays considerable attention to consumption and advocates the stimulus of rising prices attained by issuing more money.

The main contribution he makes is probably his "period analysis." He advocates an objective analysis of a *flow* of funds in successive short periods of time, and treats the savings of one period as related to the income of the preceding period, thus differing from Keynes.

3. Overinvestment Theories of Overproduction, Monetary. — Ludwig Mises (b. 1881) made his theory of cycles a part of the Austrian School's general theory.[2] Starting from a Böhm-Bawerkian concept of equilibrium, in which interest equals the true difference between the value of future capital goods and present consumer goods under a competitive price system, Mises treats cycles as the result of a continuous tendency among politicians and businessmen to favor inflation of bank credit —

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[1] *A Study of Industrial Fluctuations*, 1915; *Banking Policy and the Price Level*, 1926, 3d ed. 1932; *The Control of Industry*, 1923; *The Ebb and Flow of Unemployment*, 1923; "Mr. Keynes and the Rate of Interest," and "The Future of Trade Cycle Theory" in *Essays in Monetary Theory*, London, 1940.

[2] *Theory of Money & Credit*, Ger. ed. 1912, Eng. trans. 1934. Mises is a strong defender of competition and critic of socialism. He presents a notable attempt to explain the value of money in terms of marginal utility. His general system is set forth in *Nationaloekonomie*, Geneva, 1940 (Revised and enlarged edition in English, 1949 under title of *Human Action*).

the "inflation ideology" of central banking authorities. This results in periods of low money rates, and rising prices of capital goods in comparison with consumer goods. Even after full employment, the banks extend more credit, and this, while it adds no new capital goods, results in withdrawing some from other lines, in order to carry on the expansion. The result is malinvestment. Finally, prices of goods other than durable capital goods decline, bankers cease to extend credit, and the crisis develops.

On this base, Mises's pupil, Frederick A. Hayek (b. 1899) has erected a more elaborate and complete theory of cycles which may be taken as representing a full development of the so-called overinvestment theory.[1]

In the background, is the assumption of a predominant tendency toward equilibrium at full employment, one condition of which presumably is that money rates of interest will equal an equilibrium rate, as in Mises's theory. But Hayek puts the emphasis on the *initial disturbance* which starts a cycle. This he takes to be the persistent tendency to create new bank credit in the shape of unwarranted advances to enterprisers.

He emphasizes that, while this is not a mere monetary theory, it does accept the theory that cycles cannot be explained without considering money (credit) as a factor. Indeed, the "elasticity" of the money supply (MV) is what allows and facilitates the disequilibria of business cycles. By expanding the currency, malinvestments in capital are generated, which are not productive enough to be maintained.

Here two points stand out in Hayek's cycle theory: (1) the difference between "voluntary saving" and the creation of new credit currency by banks, and (2) the importance of the enterprisers' anticipation of rising prices. Voluntary savings are related to production that can be maintained (in a free society), while the new credit currency is inflation, and cannot be maintained indefinitely. The enterpriser, anticipating rising prices, and aided by money rates below the equilibrium rate, plunges into overinvestment.

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[1] Hayek's main ideas are to be found in *Profits, Interest & Investment* (London, 1939). See also *Geldtheorie und Konjunktur Theorie* (Vienna, 1929) and *Prices and Production* (London, 1931).

Now comes a third point, the idea of (3) the vertical "structure of production," and the different effects of price rises on the various stages. There are production goods (remote), intermediate goods, and consumption goods (near); and the proportions of the total demand that apply to these classes are important. As banks having excess reserves encourage businessmen to borrow at below-normal interest rates, an overexpansion of investment develops. The roundabout process of producing by means of capital goods begins, and the spending of the new credit raises expenses and prices before the incomes of consumers can rise. "Forced saving," or inability to buy the usual quantity of consumers' goods, results. *As long as the investment feeds on new bank credit, and thus exceeds voluntary savings*, this phase continues. The result is a maladjustment in the structure of industry — one that cannot be maintained.

At this point, a crisis comes, when, bank reserves being inadequate, the banks cease expanding loans. Underwriters find difficulty in disposing of new securities. Overexpanded investment programs are checked.

Then demand shifts from production goods to consumption goods. The purchasing power created by the banks reaches consumers, whose lagging incomes thus catch up with prices. They are relieved from forced saving, and resume customary spending. Consumption demand now becomes too great. Consumption goods prices rise. The inflation is renewed on this level, with further credit expansion, and higher market rates of interest and wages. Finally, money rates equal the normal rate, profits disappear, and expansion ceases. Investments in roundabout processes which have not been brought to completion so that consumption (near) goods can be turned out, are unable to pay. Investments are lost, unemployment develops, and depression sets in.

Closely connected with this overinvestment theory of cycles, is the concept of money as "neutral." Theorists of this sort generally regard money as a mechanism which should not be manipulated for control purposes, but should be provided in sufficient quantity to avoid disturbances from this source. One test of a neutral adequacy of supply is found in the relation between investment and saving: the supply of money should be such that voluntary savings (other than hoarding) will tend to equal investments for profitable production.

Unquestionably, Hayek's theory provides a more adequate basis for understanding modern cycles than its predecessors. It has been widely adopted, particularly by "value economists." A notable presentation of the general idea is made by Lionel Robbins of the London School of Economics in explaining the great depression of the thirties.[1] The French economist, Nogaro, appears to accept a similar approach.[2]

Though fairly satisfactory as a description of cycles in recent times, these "overinvestment" theories leave several questions to be answered: (1) As to causation, *why* is credit always abused? *Why* are the limits of bank reserves exceeded? *Why* does credit necessarily outrun the demand for it — isn't a constant increase in currency (gold or credit currency) theoretically possible without harmful "forced saving"? (2) Isn't it an oversimplification to explain industrial maladjustments and corrections in terms of money or credit?

It may be pointed out that in the statement of the theory, great reliance is really placed on various psychological and technological factors such as entrepreneur anticipations, consumption habits, and industrial structure, so that it might be suggested that the explanation actually presented is much broader and more complex than the mere excess of bank credit used for investment.

Finally, what about cost? To some it will seem that there can be no basic criterion of "productive" investment without allowance for real costs such as the irksomeness of labor, saving, waiting, and bearing non-insurable business hazards. Here may be seen a limitation of the Austrian School's general theory.[1]

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[1] Robbins, L., *The Great Depression*, London, 1934.

[2] Nogaro, B., *La Crise Économique dans le Monde et en France*, 1936.

4. Underinvestment Theories of Underconsumption. — The preceding overinvestment theories of cycles regard savings as the *supply* of funds for investment in capital goods. The trouble comes through overspending in the way of investment in instruments of production. They stress the fact that too much credit is used in this way. Thus these theories belong to the overproduction family.

But just as underconsumption theories have always arisen in opposition to overproduction theories, so *under*investment theories soon arose to challenge the theories of Mises, Hayek, and others. As members of the broad underconsumption family, these point to underspending; but, as opponents to overinvestment ideas, they assert that the source of the underspending lies in under*investment*.

The underinvestment theorists, instead of regarding savings as a potential supply of capital, treat them as a reduction of spending. They think of savings as withdrawn from spending for consumption. This is supposed to cause a decline in prices, and business recession.

While the overinvestment theorists stress the limits of credit, and the *excess* of credit for capital goods, the underinvestment theorists regard credit as having unlimited possibilities as "purchasing power," and say that any "excess" lies in voluntary saving (affecting investment).

The "under" type of theory is apt to arise in periods of depression, when the boom is over, and people no longer have enough purchasing power to buy all the goods being produced at the existing prices.

At such times, too, a "remedy" is called for by many people. This may be sought either in regulation of interest rates or money supply, or in control over incomes and spending. Down to the thirties, the more common tendency was to rely on monetary controls. But experiments with regulated money rates and supplies of money were disappointing. Thus attention was directed toward control of income — the "national income" as a total.

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[1] See above, pp. 612, 632–633, 618, 629.

The combination of these conditions — depression and the emphasis of national income controls — is among the most important elements in the underinvestment cycle theories. Add the further condition that, in connection with war finance, there was a great development of currency inflation and "management," and the main bases are complete.

The demoralization that attended and followed World War I is to be noted. The abandonment of monetary standards and the inflation which mark the period are evidence of this. It seemed to many that economic laws had all been broken, showing their unreality. Men asked: Where is this thing called equilibrium? What is "normal"?

The first widely influential underinvestment theory came from R. G. Hawtrey (b. 1879), an economist connected with the British Treasury from 1919 to 1937.[1]

To begin with, Hawtrey presents a monetary theory. In general, he holds that monetary conditions are controlling, and ignores technological changes such as new processes or obsolescence as affecting capital goods. He assumes production, as being something that is conditioned by bank credit: it exists, and Hawtrey is concerned only in changes in it. He refines the quantity theory of money, emphasizing velocity of *net* credit changes, and the idea of a stream of money buying a stream of goods. Thus he moves toward the idea of circular flow. Indeed, Hawtrey's theory of cycles may be said to rest upon *changes in the flow of currency* (bank credit); that is, changes in net cash balances. These changes are effective through consumer outlays, or spending. These he calls demand, and so he goes on to treat "money" as constituting demand, or purchasing power.

A point to be stressed is that Hawtrey includes under the head of consumer outlays all finished goods, not only consumer goods, but also finished producer goods, or capital. The underconsumptionist, Hobson, put fixed and circulating capital together; so now the underinvestment theorist puts finished consumer and producer goods together. This indicates how such theories go with a lack of recognition of the time factor as affecting production.

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[1] Born in 1879; author of *Good and Bad Trade* (1913), *Currency and Credit* (1919), *Monetary Reconstruction* (1923), *Trade and Credit* (1929), *The Art of Central Banking* (1932), *Capital and Unemployment* (1937), *A Century of Bank Rate* (1938).

The problem of the originating cause of cycles is hardly touched by Hawtrey. He assumes that total bank credit expands, as banks reduce money rates or conduct open market operations, thus changing the flow of currency. He assumes that this increases total demand for finished goods, and that prices rise. Traders use easy money for forward buying and speculation. They accumulate inventories. But consumer income lags, and what Hawtrey calls "passive investment" arises. This is a form of underspending which is the disturbing factor. Uninvested savings are not spent. They are passive, and involuntary (idle or hoarded), thus resembling the "forced savings" of Hayek's theory.

But the point, to Hawtrey, is that they are not spent — are not actively circulating. The expansion apparently could go on indefinitely, if only the total velocity of circulation (MV) were maintained. Accordingly, the conclusion is that cycles can be controlled by bank credit operations. It is argued that the gold standard had been a cause of periodic crises and recessions, coming as gold reserves limited credit expansion.

By 1937, however, Hawtrey was forced to admit that his theory did not always work.[1]

This "underinvestment" theory has been criticized as not dealing with the cause of the cycle — what starts the expansion? It certainly shows a one-sided emphasis of demand, and ignores important technological and psychological factors. It deals with totals without allowing for changes in the distribution of income and expense among individuals, and thus rests on a macro-economic concept of equilibrium.

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[1] See *Capital and Unemployment*, p. 86.

While J. M. Keynes did not develop a complete theory of the business cycle, his thought much influenced others. Nor is it difficult to say toward what cycle theory he tended. Keynes preceded Hawtrey in the British Treasury, and was influenced by the latter, particularly in his treatment of money as being credit, and in his cycle ideas. It may be said that his thought warrants classifying him as an *underconsumptionist of the underinvestment type.*

But Keynes was influenced by Neo-Classical thought and by the Austrian School. Then he differed from Hawtrey in holding that saving tends to equal investment. (This Hawtrey denied.) And in his earlier thought he emphasized the interest rate as a factor, arguing like Wicksell that low money rates, relatively to the equilibrium rate, would prevent underinvestment. He stressed maladjustment between saving and investment.[1]

In his *General Theory* (1936), Keynes went over completely to a circular-flow economics — more so even than Hawtrey. His basic assumption was: Income = Spending. But, as that part of total spending which goes for consumption is a constant function of income, saving varies with variations in income. Planned saving tends to diverge from planned investment, causing periods of underinvestment spending. This results in underconsumption. The remedy is increased spending by the state to correct the deficiency in private investment.

Keynes's idea of a fixed "propensity to consume" has done much to encourage underconsumption cycle theories in recent years.

Keynesian economic theory, however, is timeless: It allows for no lags in time. This prevents the development of a theory of periodic cycles. Moreover, his treatment of consumption spending as a constant does not allow the use of the "acceleration" idea of cumulative effects which play a part in most cycle theories (e.g., Spiethoff and Wicksell).

The main characteristic is to emphasize tendencies to disequilibrium — tendencies toward "secular stagnation" (long-run depression).

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[1] *Treatise on Money*, 1930.

It remained for a disciple of Keynes to apply the Keynesian technique to an explanation of business cycles. In R. F. Harrod's *Trade Cycle*, 1936, we find what is probably the most complete and consistent theory based on underconsumption due to under-investment (or oversaving), of the Keynesian type.[1]

Harrod (b. 1900) presents an elaborate set of dynamic factors and static factors, the dynamic factors tending to cause changes, the other to limit such changes. Thus one would expect to find at last an explanation of the origin of cycle movements. But the dynamic factors work only *after* some change has occurred. Thus the "propensity to save" is seen only as income rises; the "shift to profits" occurs as prices rise faster than wages; and the proportion of capital per unit of product varies as production (and interest rates) change. The analysis seems to start with an assumption that total income rises. Thus the three dynamic factors are hardly causal.

Once a movement does occur, Harrod's "static factors" are supposed to set limits. Lagging wages and raw material prices, diminishing returns, and diminishing elasticity of demand, work through the price system toward stability. But what causes the initial movement? At one point Harrod appears to blame oscillations in the value of money for business fluctuations, but that is not his main theory.

The account he gives of the trade cycle runs somewhat as follows: Starting at bottom, we find unemployed labor and capital, the labor unemployment being assumed to be the greater of the two. With "revival" comes increased consumption. This increase in consumption, according to the principle of "acceleration," causes increased investment in capital goods by those who anticipate further increases in consumer demand. Thus "the relation" between the demand for consumer goods and capital goods is affected. Unless the relatively high level of consumption can be maintained, a limit will be reached.

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[1] Harrod's other works: "Notes on Supply," *Econ. Jr.*, 1930; "The Law of Decreasing Cost," *Econ. Jr.*, 1931; *International Economics*, 1939; *A Page of British Policy*, 1946; *Are these Hardships Necessary?*, 1947; *Toward a Dynamic Economics*, 1948.

But as investment increases, the "multiplier" comes into play, bringing increased employment, production, and income. Unemployment declines, and the *rate* of increase in consumption diminishes. (Spending for consumption fails to keep pace with income, so that idle savings increase.) Then the investment opportunity and orders for capital goods decline, and depression ensues. Once the decline in investment starts, it can hardly be stopped.

The bottom comes when the money rate is low compared with the investment yield, and the capacity to save is so reduced that equilibrium is restored.

Since the trouble seems to Harrod to lie in inadequate spending for investment at the peak of the cycle, he proposes as a remedy that public "investment" spending be resorted to at that point. This clearly shows the type of his cycle theory.

Harrod's emphasis of "acceleration" requires special mention: He makes much of the idea that changes in the production of consumer goods have a magnified effect on producer goods, particularly on fixed capital. He develops the effects of Keynes's "propensity to consume." Adopting the notion that Income = Spending, and that therefore Saving = Investment, he refines the doctrine by arguing that new credit currency created to stimulate business is "saved" by all those who receive it, say by wage earners — saved, that is, till spent! Thus he would make "saving" include the receipt and momentary holding of credit currency. The spending is treated as "dissaving."

His treatment of the international aspects of cycles, and his empirical method — he praised W. C. Mitchell — are notable.

Emil Lederer[1] and Hans Neisser[2] are to be mentioned as German-trained representatives of the underconsumption approach, but one which does not depend upon underinvestment. They treat changes in consumption spending as the most important factor in cyclical fluctuations. While recognizing the influence of technological changes, they emphasize monetary factors. Lederer's theory appears to rest on *lagging wages*. Neisser attaches great importance to international conditions.

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[1] "Konjunktur und Krisen" in *Grundriss der Sozialökonomie*, 1925; *Technischer Fortschritt und Arbeitslosigkeit*, 1931; "Industrial Fluctuations and Wage Policy," *International Labor Review*, 1939.

[2] "General Overproduction" in *Jr. Pol. Econ.*, 1934.

Summary Analysis of Cycle Theories. — Looking back, one sees in the history of cycle theory several main developments:

1. Obviously, there has been the development from the idea of "crises" or "revulsions," as occasional periods of hard times, to the idea of regularly-recurring cycles, each of which has similar characteristic phases. This development is not yet complete, and some doubt as to the true cyclical character of crises still exists. It seems likely, however, that study of the growing mass of data concerning external and internal factors is tending toward the conclusion that cyclical swings exist in business activity and prices, which are recurrent with the same sort of rhythm that characterizes the life of man on the earth. The life of the individual, and therefore of any group of individuals, is a series of oscillations required to avoid the extremes that would destroy such life, and, in that sense, are required to maintain equilibrium as existence. Short and long life cycles mark the range within which individuals and groups survive. Thus business cycles, it seems, will finally come to be regarded as reflecting a continuous tendency to changes in equilibrium.

2. Clearly, too, the development has been from separate and incidental theories of cycles, to theories which are integrated with the general economic theory and reflect the fundamental characteristics of such theory. It should now generally be possible to deduce the thinker's economics from his theory of cycles.

3. If he recognizes the existence of cycles, and is an extreme idealist, he will doubt that cycles (or the depression phase) are inevitable and will consider it possible to eliminate them. The extreme materialist will consider cycles as inevitable and irremediable. The dualist may accept regulation and the possibility of more or less modification or minimization.

4. Much depends on the thinker's concept of equilibrium, and his acceptance or non-acceptance of a tendency of economic "forces" toward an equilibrium. At bottom, the tendency of Classical and Neo-Classical economists is to see equilibrium as "normal" and consisting in a balance between opposing sets of demand and supply forces, working through voluntary individual choices. But mostly they have overemphasized "cost." And, by leaving profits as a residual claimant, they cannot explain fully a tendency to equilibrium. *Their theory concerns the "natural" or "normal" equilibrium level itself*, not the oscillations around that level. The Socialists have seen some sort of "good" equilibrium in the satisfaction of "needs," under conditions of substantial equality. They see such "good" equilibria destroyed by inequalities which result from "exploitation." This they regard as unnecessary, except under competition and private property in production goods.

"Price economics" tends toward a multi-equational "general equilibrium" among price-determined preferences. This affords no "normal" equilibrium. Real costs are not considered. The level of equilibrium is, therefore, a matter of "indifference" between "substitutes." Demand and supply are interrelated, being price-determined quantities, and "mutually" determined. Thus no theory of *causation*, either of value or of cycles, can be forthcoming. So the resort is to assumption of disequilibrium (tops or bottoms of cycles) to start with. "Normal" becomes a mere *ex post* line of secular trend computed mathematically to fit statistics or accounts.

Finally, with the return to the macro-economics and circular-flow theories of the Physiocrats, we find some abandoning any concept of an equilibrium of forces. Instead, there is the idea of continuity in the flow of total money income according to some preconceived or arbitrarily selected rate within a closed system or circuit. The only basis for cycles, then, lies in assumption — the assumption that for some reason or other (not a part of the circular-flow theory proper) the rate of flow *changes*. Usually, for example, the credit currency is assumed to expand

and thus to increase income, which in turn is assumed to reduce that part of spending which is called investment.

5. The age-old cleavage between "over" and "under" cycle theories is easily explained.

It will be noted that the *over*production and overinvestment theories are all on the basis of free individual choice among producers as well as consumers. Competition is assumed, and on that assumption a theory of value is developed. All attach much significance to non-monetary or "real" factors. Thus they are associated with some theory of production, especially some explanation of the function of capital goods. Saving is treated *positively* as the supply of investment funds. Interest serves to cover time costs of production, and to cause a tendency for savings to equal investment.

The *under*consumption and underinvestment theories, however, all are associated with a belief in considerable limitation on free individual choice and competition, in order to eliminate inequalities of income, exploitation, etc. Either they take production and income for granted, or they regard all labor-time or employment as productive. Most "under" theories tend to fall back on state-created purchasing power and some sort of fiat currency, treating such purchasing power as equivalent to demand. Saving is regarded as a restriction of income. Capital goods are generally ignored or treated as stored-up labor. Saving is treated *negatively*, as a reduction of spending or investment. Interest is either decried or regarded as unimportant as a governing factor.

6. The "over" theories are mostly micro-economic. The "under" theories all tend toward macro-economics, and are concerned with totals and averages, not margins.

7. "Over" theories may develop under any conditions, but are clearly predominant in periods of relative prosperity. "Under" theories are generated and thrive in periods of depression.

8. The latter point is emphasized by the fact that the underconsumption theories hardly attempt to explain periodic cycles.

They emphasize recessions. The tendency is to rely upon some constant tendency to disequilibrium that reduces consumption. Thus, when closely examined, they tend toward some long-run development rather than to cycles. They lead to stagnation, and revolution or radical reform.

The main deficiency of cycle theory now appears to lie in the matter of causation. This weakness appears in the general tendency to start the statement of theory with the assumption of some change. Either a "bottom" is assumed, from which expansion begins, or a "top" and recession therefrom. Then, when the movement-by-assumption is well under way (by assumption), some limit is assumed as being necessarily reached, so that (eventually, or sooner or later!) the assumed movement ends. The tendency to rely too much on "multipliers" and "acceleration," is often a symptom of inadequate theory of causation. Also the doubt and lack of agreement about periods and periodicity have a similar significance.

It seems that the cause of the business cycle and its illusive "periodicity" must be complex. The most reasonable explanation of the present condition of the theory is that there are several causal factors and many different cycles underlying the broader general cycles. External as well as internal factors are to be considered. Some are active or dynamic, some passive or static. Particularly promising seems the analysis of different cycles as affected by the life periods of buildings, hogs, and the like.

The forces which cause and condition business cycles may well be analyzed as including some which are constant (human motives), some periodic (sunspots, replacements), some occasional (innovations). Such analysis, together with the study of particular sub-cycles, seems the only way to explain the great differences that exist among cycles that are similar.

Time is of the essence. There can be no real cycle theory for a timeless economy. By the same token, it is to be asked, how can any cycle theory exist on the assumption of separate "slices" of time, or so-called period analysis? Certainly the danger of projecting "trend" lines has been sufficiently demonstrated by the failure of business forecasts. Such procedure must always be *ex post.* In cycle theory there is great need of a treatment of time as a *continuous* stream in which phenomena are observed at a given point but always as related both to the past, through memory, and to the future, through anticipations.

It seems reasonable to say that a theory of cycle causation must include at least the following elements: psychological, technological, monetary, credit, value, and price. If cycles exist, they are part of economic life and require reference to all the conditions of such life.

And surely no cycle theory can be causal and complete which does not proceed from an understanding of economic law based on human motivations and choices. If laws of diminishing marginal utility, and of diminishing marginal productivity exist, must they not be part of any true theory of business cycle causation?

At present, it seems fair to say that the cycle theories of Pigou, Schumpeter, Hayek, and Robertson, with some use of Harrod's dynamic and static factors (or the author's active and passive factors), Carver's "accelerator," and the author's analysis for price-volume relations,[1] could by *real synthesis* supply an ample basis for a true and adequate theory of business cycles.

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[1] The P/V Line. See Haney, L. H., *Business Forecasting*, 1931; *Value and Distribution*, 1939, pp. 334–338. Cf. Wagemann, E., *Economic Rhythm*, 1930, pp. 137–138.

CHAPTER XXXV

MONOPOLISTIC AND IMPERFECT COMPETITION[1]

Early Assumptions concerning Competition. — From Adam Smith's day, most of the leading non-Socialist economists assumed a condition of competition in which monopoly was exceptional, and in which other limitations were not sufficient to prevent markets from generally representing voluntary individual choices. Few if any of the economists of the first half of the nineteenth century, however, assumed *perfect* competition. Mostly, though little concerned about precision in the matter, they recognized that various frictions and clashes of interest exist, which would make competition imperfect.

Mostly, too, they were concerned with "the long run" tendency toward a condition not immediately or precisely attained. They assumed sensible men, actuated by self-interest — by a

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[1] See White, H. G., Jr., "Competition, Monopolistic and Imperfect," *Amer. Econ. Rev.*, 1936.

A Survey of Contemporary Economics (Ellis, H. S., ed.), 1948, Chap. I by Haley and Chap. IV by Bain.

Machlup, F., "Monopoly and Competition: A Classification," *Amer. Econ. Rev.*, 1937; "Evaluation and Practical Significance of the Theory of Monopolistic Competition," *Ibid.*, 1939.

Boulding, K., "The Theory of the Firm in the Last Ten Years," *Amer. Econ. Rev.*, 1942.

Morgenstern, O., Lewis, H. G., and others, on Imperfect Competition, Duopoly, Oligopoly, Monopoly, Games, etc. in Papers & Proceedings of Amer. Econ. Assoc., *Amer Econ. Rev.*, 1948.

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Coase, R. H., "Some notes on Monopoly Price," *Rev. of Econ. Studies*, Vol. V.

Fisher, I., "Cournot and Mathematical Economics," *Quart. Jr. Econ.*, 1898.

Nichol, A. J., "A Reappraisal of Cournot's Theory of Duopoly Price," *Jr. Pol. Econ.*, 1934; "Edgeworth's Theory of Duopoly Price," *Ec. Jr.*, 1935; "Robinson's 'Economics of Imperfect Competition,'" *Jr. of Pol. Econ.*, 1934.

Leontief, W., "Stackelberg on Monopolistic Competition," *Jr. of Pol. Econ.*, 1936.

Chamberlin, E., "Monopolistic or Imperfect Competition?", *Quart. Jr. Econ.*, 1937; Bibliography, *Monopolistic Competition*, 6th ed., 1948, pp. 277–310.

Also see footnote references on following pages.

"propensity to truck," or by desires, the latter often confused with pleasure calculations. These assumptions underlay their "law of supply and demand."

Often, not always, the tendency was to consider competition as a "good" condition, on the ground that it tends to maximize the production of those goods which individuals desire and find it worthwhile to make. They were not concerned with any hypothesis of "optimum output" for an individual or firm, but with abundance for society or nation. And they distinguished between production in terms of goods ("value in use") and production in terms of exchange values — between well-being and wealth.[1]

All this "ideology," of course, involves difficult assumptions as to the nature of man, of society, and of the environment. A few stated their premises; many did not. But criticism piled up from early Socialists, Institutionalists, and Historicists who attacked them. Always, the goodness or desirability of competition was under fire, the criticism in early days being directed against customs and institutions which prevented equality, whether of wealth or opportunity. And as the attacks continued, economic theory was somewhat refined, notably by Mill and Cairnes. Different "cases" of value determination were distinguished. The problem of what constitutes a "natural" equilibrium, and the problem of the *definiteness* with which a "natural value" can be determined became more and more evident.

For one thing, the growth of business organization and voluntary associations brought more collective or group activity and bargaining — trade associations, cartels, labor unions, corporations, and the like.

And as the market and pricing mechanisms grew more complex, the difficulty of relying on the older concepts of barter, or the newer concept of utility, increased. To this effect, the growing use of bank credit contributed mightily. Accordingly, the strain of "price economics," always apparent in Classical thought, came out as the difficulties of "real" value economics grew.

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[1] Cf. Ricardo, D., *Principles of Political Economy*, 2d ed., Chap. XX.

Thus the market place seemed to give little satisfaction in definitely determining prices, or in assuring that the maximum productivity would be attained. And the law of supply and demand seemed to have come to mean no more than that quantities bought and sold are adjusted to prices.

Some economists tended to make their system of thought more abstract, consciously eliminating the imperfection of actual competition. Others tended to reject abstraction, and to resort to description of cases and induction. A certain French mathematician took the former course, but chose to treat monopoly as the one limit to competition — as the negative or reciprocal of competition. Under the circumstances, this seed took root and eventually bore fruit in the theory of imperfect or "monopolistic competition."

Cournot and Duopoly. — Antoine Augustin Cournot (1801–1877), French mathematician and philosopher, in 1838[1] made the assumption of monopoly his starting point, and stated the law of demand in the form of a price-determined equation, $D = F(p)$ — quantity demanded is a function of price. He argued that the maximum total value is obtained by multiplying quantity demanded by price. Beginning with the theory of price for a single monopolistic firm, he introduced (in lieu of a less perfect condition of monopoly) another monopolistic firm — the case of "duopoly," and attempted a determinate solution, concluding that the price would be lowered and lie between the monopoly price and the price under pure competition. Finally, he considered the case of joint demand for copper and zinc (to produce brass), assuming no other use for the two raw materials and each to be supplied by a monopoly, concluding that the price would be higher (as a result of increased unit costs); but hardly determinate. Cournot's mathematical studies led him to assume that diminishing unit costs make perfect competition impossible, and lead to monopoly in an industry. Cost he treats

[1] *Principes Math. de la Théorie des Richesses.*

as money expense, with no allowance for disutility cost or for profit.

Little attention was paid to Cournot's approach at the time. His reasoning was criticized by Bertrand in 1883.[1] Alfred Marshall refers to it critically in the first edition of his *Principles*, 1890. And Pareto and Edgeworth discuss it in 1896 and 1897.[2] The general idea in this discussion was that Cournot had not sufficiently considered various possible assumptions, and that with two monopolies as sellers, the price would be unstable, possibly falling to zero if the supply could be increased indefinitely.

Marshall's Time and Thought. — Meanwhile, developments in the business world were affecting competition and the conditions of economic theory. The growth of "trusts" and cartels attracted attention. Associations of businessmen and trade unions multiplied and grew in power. Advertising and selling technique became increasingly important. And government regulation was invoked to protect consumers and competitors alike. Agreements and bargains came to play a larger part in the determination of prices.

Of course, these conditions affected the theories of the economist, and this effect became most influential through the writing and teaching of Marshall, which played an important part in the history of limited-competition theory. This is true in two respects: (1) Marshall directly kept the idea of limitations on competition alive, and called attention to Cournot's thought. He pointed to the possibility that diminishing unit costs might lead to cut-throat competition and monopoly. He probed into a number of difficulties in the assumption of a tendency toward equilibrium under competition. (2) Indirectly, too, the unsatisfactory character of some of Marshall's doctrines contributed to encourage a reconsideration of the monopoly approach to price problems. Thus he failed to keep demand conditions sufficiently independent of supply conditions to avoid circularity. This is the great defect of "price economics," which leaves "value" undetermined and indeterminate. (When "demand" and "supply" are both considered as dependent upon "price," what becomes of a law of supply and demand as governing the determination of price?) To make things worse, the value of money was assumed by Marshall, both in the demand schedule and in the supply schedule, under the guise of marginal utility. Probably Marshall's unfortunate attempt to separate long and short time periods contributed also to a tendency to ignore time altogether, which is characteristic of monopolistic competition theory. Add his inadequate treatment of the margin and the "representative firm," and the lack of a definite concept of the enterpriser and his function,[1] and the reason for saying that Marshall's thought left the door open for monopoly or imperfect competition theories is apparent.

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[1] *Journal des Savants*, p. 503.

[2] Pareto, *Cours* (1896), p. 68; Edgeworth, "Theory of Pure Monopoly," *Papers relating to Political Economy*, Vol. I., p. 111 (translated from Italian article of 1897).

The Development of Limited-Competition Theory. — So it was that, soon after Marshall's passing, there appeared a tendency to move out of the symmetrical house of theory which he constructed. The movement showed two distinct influences.

On the one hand, a pupil, Piero Sraffa, in 1926 published "The Laws of Returns under Competitive Conditions."[2] Starting from a criticism of Marshall's theory, particularly the normal supply curve, Sraffa departed from the assumptions of competition, and moved to the assumption of monopoly as a base. He argued that diminishing unit costs make for instability and tend toward monopoly. He adopted the negatively-inclined price-determined demand curve (sales) for a single seller, and argued that the position of such a seller is in kind, if not in degree, that of a monopolist.

In 1930, in a symposium discussion in the *Economic Journal*, a number of leading economists reached substantial agreement that, unless all competitors are proportionately affected, diminishing unit costs will disturb equilibrium. It was also agreed that when imperfect competition exists in an industry, it is impossible to assume a tendency to the optimum output.[1]

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[1] Cf. above, pp. 648, 653.

[2] *Economic Journal*, vol. 36, p. 535.

It may be doubted that the new theories would have attracted the attention they did had there not come the great Depression of 1931–1936, and the widespread revulsion of feeling toward almost everything pertaining to the theories and practices of the days before 1929. As part of this change, the attitude of economists toward competition tended to change. And the event of the N.R.A. in 1933 marked an upheaval which sharply called attention to problems of competition and pricing in the United States, and brought a good many economists for the first time face to face with them as they actually are.

Particularly to be noted, is the way the rise of Institutional Economics added to the interest in "monopolistic competition," naturally mostly in America.[2] Institutionalism, while it is fundamentally opposed to such doctrines as static equilibrium based on rational choice, helped clear the way for the new doctrine by attacking all theory based on a competitive price system, and joined in emphasizing the institutional limitations of the economy. Both Institutionalism and limited-competition theory stress the business combination, collusive trade practices, product differentiation, and other conditions restricting competition.

At about this time, or a little later, articles by Hotelling,[3] Shove,[4] and Kahn[5] appeared. Finally, in 1933, came Mrs. Robinson's *Theory of Imperfect Competition*. This work seems to have been stimulated by the foregoing discussions and to have been an attempt to do what Sraffa had asked for: "to abandon the path of free competition and turn in the opposite direction, namely towards monopoly."

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[1] In 1930, too, A. J. Nichol may have helped keep the subject alive with his *Partial Monopoly and Price Leadership*, although this work was privately printed and little known, so that it probably could have had little influence.

[2] See below, pp. 770, 772.

[3] Hotelling, H., "Stability in Competition," *Ec. Jr.*, Dec. 1929.

[4] Shove, G. F., "The Representative Firm and Increasing Returns," *Ec. Jr.*, 1930; "The Imperfection of the Market," *Ec. Jr.*, 1933.

[5] Kahn, R.F., "Decreasing Costs," *Ec. Jr.*, 1932.

On the other hand, Chamberlin's contribution developed quite independently of these discussions of the compatibility of increasing returns with "competitive equilibrium." Although not fully published until 1933, it was conceived prior to 1927, when it was submitted as a doctor's thesis at Harvard.[1] Chamberlin's thought, which is concerned directly with the problem of effecting a synthesis between the traditional theories of monopoly price and of competitive price, seems to have originated in a dissatisfaction with the two theoretical extremes as being out of accord with economic reality. He sought to integrate them into a single structure. One chapter of his work was published in 1929, and the complete study in 1933.

The Scandinavian economist, Zeuthen,[2] and the German, von Stackelberg,[3] also made independent contributions.

Thus a market-value theory not based on perfect competition was established.

Chamberlin's "Monopolistic-Competition" Theory.—Edward Hastings Chamberlin (b. 1899) in 1933 published *The Theory of Monopolistic Competition* as a reorientation of the theory of value, designed to base it on a synthesis of monopolistic and competitive theories. He argues that the old idea of monopoly and competition as *alternative* is wrong; and that most situations are composites in which elements of both monopoly and competition are combined. But he asserts that the correct procedure is to *start* from the theory of monopoly. This, he thinks, has the merit of eliminating none of the competitive elements, since these operate through the demand for the monopolist's product; while on the contrary the alternative assumption of competition rules out the monopoly elements.

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[1] Chamberlin appears to have begun a doctor's dissertation on the subject in 1925, and submitted it to Harvard in April 1927. He published his Chapter III on Duopoly and Oligopoly as an article in the *Quart. Jr. Econ.*, Nov. 1929.

[2] Zeuthen, F., *Den Økonomiske Fordeling* (Distribution), 1928; "Mellem Konkurrence og Monopol," *Nat. Tids.*, 1929; *Problems of Monopoly and Economic Warfare*, London, 1930.

[3] von Stackelberg, H., *Grundlagen einer reinen Kostentheorie*, 1932; "Sulla Teoria del duopolio e del polipolio," *Riv. ital. di. stat., econ. e fin.*, 1933; *Marktform und Gleichgewicht*, 1934.

Thus, in taking monopoly as a starting point, Chamberlin's approach is similar to that of Cournot.

But, while with Cournot the transition to perfect competition takes place only on a scale of numbers of competitors, with Chamberlin it takes place also on a scale of *substitution* of products. Any producer whose product is significantly different from the products of others has some monopoly of it, subject to the competition of substitutes. He considers each producer in an industry as having some monopoly in his own product. If he be the sole seller of a unique product, he has a pure monopoly.[1] If there be two sellers of similar products, the situation is one of "duopoly." If there be several, an "oligopoly" exists. The condition may range through various degrees of oligopoly to pure competition, under which there are so many sellers of a highly standardized product that any one could sell all his product without affecting the demand. Pure competition is found only under the dual condition of (a) a large number, and (b) a perfectly standardized product. The usual condition Chamberlin considers to be in the intermediate area, in which some element of "monopoly" exists, and which he calls "monopolistic competition."

Economic inertia and friction are "imperfections" which he does not consider as part of "monopolistic competition."

Thus Chamberlin's thought centers on the product. Each producer, under "monopolistic competition," faces competition from "substitute" products which are not identical and which are sold by other concerns with various price policies, and sales expenses. These merely limit his "monopoly" of his own product.

The individual demand curve (or sales) for one seller's product is then regarded as affected by the market policies of other individual sellers whose products are partial substitutes. Total sales of the partly competing group of substitute products are treated as limiting the sales of the product of any one seller. Under

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[1] So it seems to the author. Chamberlin might not use the term exactly this way.

"pure" competition (many sellers and a completely standardized product) a horizontal demand curve (average revenue) would exist for each individual competitor's product. This would mean identical prices. Chamberlin argues that "pure" competition would force all individual competitors to treat differential advantages, or rents, as costs, the same as other costs.

Chamberlin emphasizes the effect of judgments by one seller concerning his rivals' policies, possible retaliation, etc. He also argues that selling costs such as advertising are not part of the cost of production, but are incurred to increase the sales of the given product; and thus they affect the demand curve. Throughout, his basic idea is that, no matter how slight, any differentiation of a seller's product gives him to that extent a monopoly. And all these conditions, commonly found in competitive markets, are either "impurities" in the nature of monopoly elements, or are associated with such elements. They make "pure" competition impossible.

To Chamberlin, actual "competition"[1] includes the effort of competitors to increase their monopoly powers.

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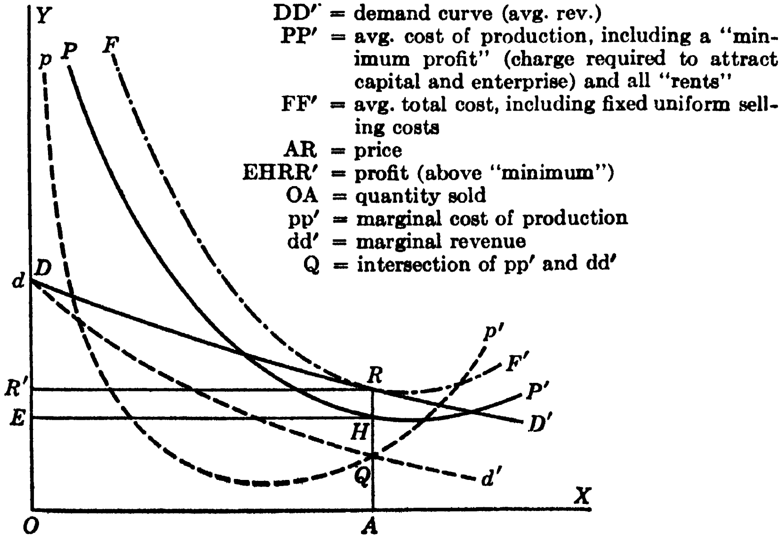
[1] The thought is represented by the following self-explanatory diagram.



DD′ = demand curve (avg. rev.)
PP′ = avg. cost of production, including a "minimum profit" (charge required to attract capital and enterprise) and all "rents"
FF′ = avg. total cost, including fixed uniform selling costs
AR = price
EHRR′ = profit (above "minimum")
OA = quantity sold
pp′ = marginal cost of production
dd′ = marginal revenue
Q = intersection of pp′ and dd′

And the essence of "monopoly," and therefore of "monopolistic competition," is seen as lying in differences — (1) differences in price policy, (2) differences in nature of product, and (3) differences in such sales effort as advertising outlays. It is a contribution of Chamberlin's to have developed the second and third of these variables as arising out of the mixture of monopoly and competition.

Chamberlin starts with a single firm and develops the idea of monopoly price and competitive prices as determined by the intersection of revenue or sales curves with expense curves. Either the marginal revenue curve, or the average revenue curve (from which it is derived), may be used to determine the monopoly output and price, the former by intersecting the rising marginal cost curve, the latter by the familiar Marshallian method of fitting the maximum profit area between it and the average cost curve, which includes rents or differentials and thus equals the average price.

The analysis with respect to all three variables then is extended beyond the firm to *groups* of sellers, which may be taken as corresponding to conventional "industries," depending on how broadly a "class of product" is conceived in a particular case. The group is analyzed, first under the assumption of symmetry (all its members assumed to have uniform cost and demand curves). Then some consideration is given to what might happen if a "diversity of conditions" existed. If selling costs are not great, and if they reduce the slope of the sellers' demand curves, increasing them may result in a lower price. Variations in product may lead to either smaller or larger outputs. Group equilibrium (with "alert" competitors) must result in the optimum with respect to all the variables, and no profits above a necessary minimum for every producer.

The conclusion is drawn that under monopolistic competition the equilibrium price is higher, and the volume of output probably (not necessarily) lower, than under pure competition. The net profits of enterprise, however, may or may not be higher than under pure competition because of the expense which is required to maintain the monopoly elements and which is often increased by a multiplication of substitute products surrounding the monopolist. Chamberlin argues that monopolistic competition need not bring higher profits to the marginal firm in a given industry. Instead it may allow the existence of a larger number of firms making normal profits.[1]

Robinson's "Imperfect-Competition" Theory. — Mrs. Joan Robinson (b. 1903) in 1933 published *The Economics of Imperfect Competition* ostensibly to show that output and price of a single commodity can be determined by a technique based on assumption of rational decision by an individual enterpriser, conditioned only by a demand that is beyond his control and by his own expenses (other than selling). One aim was to show the limitations of a theory of value and distribution based on the assumption of either perfect competition or perfect monopoly. She considers monopoly merely as the opposite of competition, and states that each seller has a monopoly of his own product.[2] It is just one of many conditions which in varying degrees make actual competition imperfect. She proposes, therefore, to modify the theory of value and distribution based on perfect competition by reconstructing demand and supply curves so that they may show the effects of various imperfections in competition.

Thus Mrs. Robinson's approach is based on that of Alfred Marshall. It is doubtful that the "imperfect competition" episode would have occurred had the leader of Neo-Classicism not himself been disturbed by so many difficulties, and left so many loopholes.

She considers each industry as concerned with one product which is essentially homogeneous.

Mrs. Robinson also starts with a single firm, and deals with its calculated endeavor[3] to adjust its output to its demand curve.

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[1] This point has been attacked by Kaldor, "Market Imperfection and Excess Capacity," *Economica*, 1935.

[2] *Imperfect Competition*, pp. 5, 52.

[3] "Each individual acts in a sensible manner in the circumstances in which he finds himself from the point of view of his own economic advantage."

But her emphasis is on the marginal revenue curve, the equalization of which with the marginal cost curve she regards as the main problem.[1] This emphasis is probably somewhat excessive, in view of the fact that the "marginal" aspect is merely a derivative of the total or average revenue. Moreover, the treatment confuses (1) the time series of varying total sales (or expenses) for a single firm with (2) the schedules of bids (or asked prices) for a market at a given time.[2]

Mrs. Robinson discusses various conditions limiting the demand curve of an individual firm, such as monopoly and competition of varying degrees, and considers price policies, quality, and service. She also discusses conditions affecting the firm's supply curve, such as increasing, decreasing, or constant cost. (She uses the long-run Marshallian declining cost curve as representing the market supply curve.)

Considerable attention is given to conditions that lead individual firms to make discriminatory prices.

She does not cover oligopoly and selling costs in her analysis, but goes beyond Chamberlin in treating of buyer's monopoly, and monopsony. This case she considers as represented by the enterpriser's buying of labor, concluding that labor is "exploited,"

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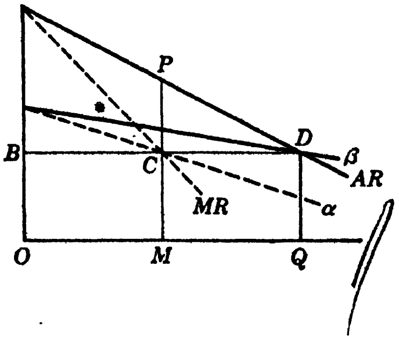
[1] Or with some point on such a schedule representing the individual firm's "bid" or asking price.

[2] The emphasis is on the marginal demand (or marginal revenue) curve as determining monopoly output in the diagram, and in this particular diagram demand and supply curves are assumed to be straight lines.



β = average cost (including rent)
AR = average revenue
α = marginal cost (including rent)
MR = marginal revenue
OM = monopoly output
OQ = competitive output
DQ = competitive price
PM = monopoly price
C = intersection of marginal revenue and marginal cost

in that (under the conditions she assumes) it does not get the full market value of its specific marginal product.

Stackelberg and Others. — A year later than Chamberlin and Robinson, the German economist, H. von Stackelberg, showed some of the implications or potentialities of the theory of monopolistic competition by independently developing it in a form suitable for Fascism.[1] In addition to the purely quantitative profit principle, he introduces several elements in pricing. These include habits, tendencies to stability, agreements, and time lags. Stackelberg distinguishes and analyzes various cases of duopoly and of joint demand.

Other German economists have developed the theory.[2]

In France, relatively little seems to have been done in this field until very recently.[3]

But in Holland and Scandinavia, a good deal has been added. One of the earlier independent thinkers in this field, F. Zeuthen of Denmark, has continued to discuss problems of price policy, advertising expense, and market homogeneity.[4] He and other Scandinavian economists have worked effectively with engineers.

Notable is the thought of J. Tinbergen, who in 1946[5] showed the results of extensive study of monopoly, duopoly, and oligopoly. He brings out the limitations of mathematical treatment of the subject, emphasizing the difference between short and long term considerations, and the existence of extra-economic motives. And W. L. Snijders has presented a searching and suggestive criticism of the theories of the leaders in limited-competition theory.[1] He emphasizes qualitative problems.

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[1] *Marktform und Gleichgewicht*, Vienna & Berlin, 1934; "Neues Schrifttum über unvollständigen Wettbewerb," *Schmollers Jahrbuch*, 1935; "Probleme der unvolkommenen Konkurrenz," *Weltwirtschaftliches Archiv*, 1938. See Leontief's review in *Jr. Pol. Econ.*, 1936.

[2] Möller, H., "Ordnung der Wirtschaft," *Archiv für Mathematischewirtschafts- und Sozialforschung*, 1939; "Die Grenzkosten als Grundlage der Preispolitik der Betriebe," *Zeitschrift für Nationalökonomie*, 1939. Schneider, E., "Absatz, Produktion, und Lagerhaltung bei Einfacher Produktion," *Archiv für Mathematischewirtschafts- und Sozialforschung*, 1938; *Einführung in die Grundfragen des industriellen Rechnungswesens*, 1939.

[3] See below p. 857. Marchal, J., *Le Mécanisme des Prix et la Structure de l'Économie*, 1946, in the main appears to follow Stackelberg. It is notable that Gide-Rist, in their *A History of Economic Doctrines*, do not mention the development of monopolistic competition theory.

[4] In English are *Problems of Monopoly and Economic Warfare*, London, 1930; "Theoretical Remarks on Price Policy," *Quart. Jr. Econ.*, 1933; "Monopolistic Competition and the Homogeneity of the Market," *Econometrica*, 1936; "The Theory of Prices," *Econometrica*, 1940.

[5] *Beperkte Concurrentie* (Limited Competition), Leiden, 1946.

In England, N. Kaldor contributed to the development of Robinson's approach.[2]

In America, after Chamberlin's book, the main tendency was toward special studies describing and analyzing the behavior of firms in deciding on prices, sales policies, and outputs. Robert Triffin[3] and G. J. Stigler[4] appear as the chief contributors to the general theory; but A. R. Burns's book on *The Decline of Competition* (1936) should also be mentioned as having had considerable influence. For the rest, there have been numerous articles and monographs dealing with the classification of markets, price policies, and spatial relations in individual industries and trades,[5] with J. M. Clark outstanding. One development is the realization that under conditions of oligopoly, the demand or sales curve of the firm may be "kinked" or bend sharply at the point of the current price, because reactions expected from competitors if the price were raised differ from those that would result if the price were reduced.[1] These writings exerted a considerable influence upon public policy concerning regulation of business, notably with reference to anti-trust procedure, price-fixing, and the "basing point system." But, after a careful study of contemporary thought in 1948, one sympathetic student of the subject ends by referring to "the extremely inconclusive and fragmentary character of our solutions to these problems at present, and the nascent character of much of the needed research endeavor."[2]

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[1] *Beschouwingen over de Theorie der Monopolitsche Concurrentie*, doctoral thesis, Utrecht, 1945.

[2] Kaldor contributed the idea of the "imagined" demand curve expressing the *expectations* of the enterpriser. "Mrs. Robinson's 'Economics of Imperfect Competition,'" *Economica*, 1934; "Equilibrium of the Firm," *Ec. Jr.*, 1934.)

[3] *Monopolistic Competition and General Equilibrium Theory*, Cambridge, 1940. Triffin considers the problem of a synthesis of monopolistic competition and general equilibrium theory, but, though he introduces the idea of enterpriser expectations and innovations, and attempts a classification of markets according to cross-elasticities of individual sellers' demand curves, he attains no general results.

[4] *The Theory of Price*, 1946; also "Notes on the Theory of Duopoly," *Jr. Pol. Econ.*, 1940; "Economics of Minimum Wage Legislation," *Amer. Econ. Rev.*, 1946; and "The Kinky Demand Curve and Rigid Prices," *Jr. Pol. Econ.*, 1947. Stigler has developed the marginal-cost curve analysis, and set up a model based on the assumption that each seller assumes competitors to endeavor to maintain their shares of the market. He discusses reaction of a firm to changes in wage rates. But he shows the limitations of statistically-derived demand curves.

[5] On classification of markets, see Triffin, *op. cit.*, Clark, J. M., "Toward a Concept of Workable Competition," *Amer. Econ. Rev.*, 1940; Bain, J. S., "Market Classifications in Modern Price Theory," *Quart. Jr. Econ.*, 1942; Haney, L. H., *Value and Distribution*, 1939, pp. 139–152. On the basing point system, see Mund, V. A., and Smithies, A., in *Amer. Econ. Rev.*, Dec. 1942, and Clark, J. M., "Imperfect Competition and Basing Point Pricing," *Amer. Econ. Rev.*, June 1943. On spatial relations in general, see Hotelling, "Stability in Competition," *Ec. Jr.*, 1929; Copeland, M. A., "Competing Products and Monopolistic Competition," *Quart. Jr. Econ.*, 1940; Smithies, A., "Optimum Location in Spatial Competition," *Jr. Pol. Econ.*, 1941.

General Characteristics of Limited-Competition Theory.— The general characteristics of limited-competition theory may be stated in outline form as follows:

It concerns static equilibrium. (Incidentally it does not touch cycle theory.)

It does not concern itself with time, time differences, or "lags."[3]

It is highly abstract. For example, in addition to the preceding points, it assumes rational individual action.

It is pure "price economics," treating demand and supply as price-determined quantities of goods. Rational calculation of pecuniary gains is assumed. The chief criterion of competition is found in elasticity of price-determined sales or revenue curves.

Its analysis is highly individualistic in the sense that it assumes self-interest motivation working in and for single firms. Little progress has been made toward generalizing it.

It sets up a negative criterion of competition as something "pure" or "perfect" in the sense of being free from impurities or imperfections. Competition is *mere* competition only when the competitors have no capacity to influence the price of the good they sell, and are not "handicapped" by inequalities in ability or in location. Though the point is not so fully developed, it is also held that *buyers* must be sufficiently numerous and equal to prevent differences in quantities bought or in other advantages from affecting full elasticity of supply for each buyer.

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[1] Sweezy, P. M., "Demand under Conditions of Oligopoly," *Jr. Pol. Econ.*, 1939; Hall, R. L., and Hitch, C. J., "Price Theory and Business Behavior," *Oxford Economic Papers*, 1939.

[2] Bain, J. S., "Price and Production Policies" in *A Survey of Contemporary Economics* (Ellis, ed.), Philadelphia and Toronto, 1948.

[3] These matters receive some attention in Chamberlin's chapter on Duopoly and Oligopoly, and in Stackelberg.

Thus one may say that the general idea is that each individual seller (or buyer) actually has a direct influence on price, and that this is an imperfection in competition, or a monopoly element, which, it is held, limits competition and largely invalidates theory based upon the assumption of competition.

The idea of monopoly, and therefore of competition, pertains to particular concrete products, not to the general abstract utility which they afford to the consumer. Thus some monopoly exists, and competition is imperfect, as long as products are identifiable, not identical. Monopoly is limited by any degree of substitution of one good for another, but such substitution does not make "competition" unless the goods are practically identical. Any power to affect the price of a concrete product (say a brand of automobile) is monopoly or imperfect competition, regardless of whether consumers get their money's worth in the way of abstract utility (say motor transport service). Then the theory pertains to influences affecting existing *prices*, rather than to the causation or determination of *values* in which marginal utility plays a vital part.

It is emphasized that in actual markets sellers have some control over the output and price of their particular concrete products, that actual competition is influenced by conditions other than prices, and that therefore the demand for a given product of a given firm does not hold up indefinitely as it increases its output — is not infinitely elastic.

The general assumption is that each seller (and buyer) is rational and seeks to maximize his own gains by equalizing his marginal revenue and his marginal expense. Thus the motivation of actual competitors is held to be essentially similar to that of a monopolist. The motivation of the monopolist is assumed to be the same as that of the competitor, in the sense that both tend to maximize their profits.

Here comes a good deal of refinement in definition and in the "technique" of deductive reasoning on the basis of the assumptions made.

All begin with a single firm, and most of the discussion concerns the equilibrium of the firm, though Chamberlin makes some progress toward bringing his theory into accord with the "diversity of conditions" affecting different producers in real life.[1] The theory is not really generalized; though a good deal has been said about an assumption of "symmetry," or uniformity, on which basis one might apply the theory to an industry.

For the single firm at a given time, enterprise can hardly be treated as are the other factors of production, and in comparison with a social point of view based on competitive analysis, the enterprise factor is left in an unsatisfactory position functionally. Profits are treated as cost only as an assumed minimum "charge." The problem of uncertainty and discount differences is hardly touched.

Much attention is given to the curves of revenue or sales per unit of product, and of expenses per unit of product, both for the single firm. Beginning with varying amounts of revenue and expense, *resulting* immediately from different prices, the limited-competition theorists derive from them curves of the marginal revenue and of marginal expense, which merely show the *addition* to total revenue or expense made by adding additional units of product to the business of the firm.

Under given conditions of average revenue and expense, equilibrium for a firm tends to be such that average revenue is equal to or above average cost (including profit in cost), and marginal revenue equals marginal expense.

The general tendency is to treat selling costs, such as advertising, as being inconsistent with perfect or pure competition based on price alone. Such expenditures are treated as evidences of impure or imperfect competition — as evidences of difference among competitors or imperfections.

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[1] *Monopolistic Competition*, 6th ed., pp. 110–113, 172–173.

Differential returns, or rents, appear to be treated as incompatible with competition.

It is denied that competition furnishes a workable ideal of social welfare. Wastes or exploitation are results of competition. The result is that more government regulation or control is seen as desirable than is seen by an economist who thinks that competition can insure a tendency to maximize production.

Grounds of Difference among Limited-Competition Theorists. — A number of questions are suggested by an examination of the differences among those who have proposed to base economic theory upon limited competition. Probably there would be no clear-cut agreement. These questions are what Chamberlin might ask Robinson, or Robinson ask Stackelberg or Zeuthen. A few of them are as follows:

What IS "competition"? The question is, not what competition isn't, or what "pure" competition is, but what is competition, *as such?* Can it be defined entirely in terms of price?

Shall we recognize two kinds of limitation on competition, one consisting in ineradicable natural differences among the competitors; the other in more or less remediable "imperfections" in their performance? If so, why not recognize many other limitations, including government restrictions?

If, under duopoly or oligopoly, the price tends to lie somewhere between the monopoly price and the competitive price, which is more helpful, to start from demand and supply as they would be under competition or as they would be under monopoly?

Is freedom of entry a criterion of competition? Is a large number of competitors? Which is the more important?

How can producers compete without selling? How can they sell without selling costs? To what extent does a definition of competition that eliminates selling costs, eliminate competition itself?

In what does the homogeneity of economic goods lie? Does "differentiation" of products having the same basic kind of utility, invalidate the assumption of competition?

Is a "product" the criterion of the single firm, or of an "industry"?

Can there be one demand curve for an industry, say automobiles? Can the individual demand curves for various makes, say automobiles, be combined into a single demand curve for the industry?

After all the discussion, is it or is it not true that diminishing unit costs alone do not necessarily result in either monopolistic or imperfect competition?

What conclusion can be reached, or what demonstration can be made, by means of a marginal revenue curve that cannot be made (and has not been made) by means of the average revenue curve from which the marginal revenue curve is derived?

Is the "demand curve" one that the "firm" expects or imagines *will be*, or is it one that actually exists, and is projected into the future realization? Does it assume rates of discount or probable average returns?

Are the profits of enterprise under monopolistic or imperfect competition caused by differences in ability or location (monopolistic impurities), or by exploitation and discrimination (competitive imperfections)?

Does the theory of monopolistic or imperfect competition lead to (1) the regulation of industry according to the degree of monopoly differentials, or to (2) the control of the economy to eliminate imperfections of competition (exploitation, etc.)?

Criticism and Limitations of Limited-Competition Theory. — Among the foregoing questions involving differences of opinion among those who reject competition as the basis of economic theory, may doubtless be found the grounds for the more important shortcomings of monopolistic or imperfect-competition theory.

Some of their critics have stressed the limitation that arises from eliminating time from consideration, as Chamberlin and Robinson admittedly do. The importance of expectations of the future is emphasized by some who accept the monopolistic-competition approach, but they seem unable to fit this element into the theory. They either assume a degree of certainty in connection with discounting future revenue, or fall back upon an assumed probability of distribution among expected returns (which abstracts from different degrees of certainty).

Others have considered as an important shortcoming the omission of qualitative differences and sociological motives. A good many non-rational conditions affecting the motivation of buyers and sellers, particularly enterprisers, are excluded by most English-speaking limited-competition theorists. Here, too, should be mentioned the criticism that a monopolist, if he be rational, cannot have the same idea as to what constitutes his maximum profit as does the competitor. Both seek to make all the money they can; but, even if the conditions of demand and cost are the same, they must know that this maximum differs under the limitations imposed by competition. Thus the assumption of identical motivation is unreal.[1]

Still others, noting the essentially mathematical approach, have pointed to the limitation that arises when sweeping assumptions are made about "other things remaining equal."

The difficulty of generalizing from such theory and deriving a theory of distribution, shows its weakness.

Unquestionably, there has been some tendency to exaggerate the novelty and importance of parts of the theory under discussion here. It is generally conceded that the "marginal revenue curve" (so much emphasized by some) has no fundamental importance. The author would add that in the theory of railway rates there had long been a theory of monopolistic competition covering cases of duopoly and oligopoly which seems to have been ignored by Chamberlin and Robinson.

It seems fair to add three points, all of which follow from the fact that monopolistic competition theory is "price economics," and takes the Marshallian entrepreneur point of view:[2]

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[1] Cf. Haney, L. H., *Value and Distribution*, 1939, pp. 144–154.

[2] See Haney, L. H., *Value and Distribution*, 1939, pp. 133–134.

(1) Competition is thought of as conditioned by price, instead of as a condition for the determination of price. That demand and supply may be regarded as *primary* schedules, preceding price determination, is hardly recognized.

(2) The enterpriser is virtually left out of the competition picture, and profits are treated as residual and tending to disappear under competition. (In this connection, the debates as to whether enterprise is a "divisible" factor are illuminating.[1])

(3) The tendency, most notable in Chamberlin's thought, to treat any difference in product, location, or selling expense as the basis of a monopoly advantage takes one back to Senior who also argued that monopoly stands opposed to "equal competition," and that difference in location gives monopoly power. As observed in discussing the early economist, to define monopoly as absence of equal competition would make "monopoly" the rule, and would make it a price-determined condition, as are all differentials or rents.[2]

Final Appraisal. — Monopolistic and imperfect-competition theory has done good service in exposing the weaknesses of any theory based on the assumption of pure or perfect competition.

It has explored the differences and interrelations between demand and supply schedules, and brought out the significance of such schedules as expressed in terms of margins, or rates-of-change in totals. Furthermore, light has been thrown on the conditions which motivate buyers and sellers, and which may enter into the determination of primary demand and supply schedules.

In this connection, it has incidentally contributed to the criticism of marginal productivity theories of distribution.[3]

Perhaps, too, it may be called a service to have focused attention more clearly on differentials, and on the problem of the enterpriser and his profits. It does not appear to have solved the problem, but may yet force economists to come to the defense of the enterpriser with an explanation of his functions as a competitor. This might show the basis for profits at the margin.

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[1] Cf. Chamberlin, *Monopolistic Competition*, pp. 235 ff. (6th ed.).

[2] Cf. above, p. 347 f. Chamberlin undertakes to limit location differences as a monopoly element to urban rents.

[3] Cf. Chamberlin, E., *The Theory of Monopolistic Competition*, 6th ed., Chap. VIII.

Some progress has been made toward a better understanding of how such differences among competitors as exist in location, quality of product, and "identifications," affect competition.

Certainly, much has been done by the theories here considered to develop the concepts of "monopoly" and "competition" in a way that must compel economists to adopt some adequate definitions of these terms. The inadequacy and confusion of defining one thing as being the absence of another should be apparent by now. It is time to define competition in positive terms as a condition of voluntary action on the part of individual producers and consumers as buyers and sellers.[1] It is about time to begin by recognizing that a long list of conditions other than monopoly may interfere with competition — habit, custom, government, ignorance, inertia, etc.

When this time comes, some of the techniques worked out by the theorists of impure and imperfect competition will be found useful in making allowance for the market effects of the various impurities and imperfections that may affect competition. The problem of "basing points" is a case in point. Considerable progress has been made in figuring out how differences among competitors affect the working of competition, particularly in cases of duopoly and oligopoly.[2]

But all problems of economic value concern some sort of equilibrium among elements that are *different*. They involve solving the problem that arises out of differences in individual valuations. Competition may be thought of as existing *because* of these differences, and its end is then to determine the amount of differences objectively, so that they can be generally accepted and "settled." Does it not follow that a concept of monopoly as lying in singleness of kind, or uniqueness, can hardly furnish the basis for solving the problem? On the other hand, is it necessary to assume that true competitors must be equal?[1] It seems that the theory of monopoly cannot serve as the basis for a theory of value in an economy of voluntary individual choice.

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[1] Cf. Haney, L. H., *Business Organization and Combination*, 3d ed., 1934, pp. 468 f., 526 f.; also *Value and Distribution*, pp. 130–138.

[2] Cf. Ellis, ed., *A Survey of Contemporary Economics*, 1948, pp. 21, 22, and footnotes.

This thought brings us to the final question: If impurities and imperfections make competition so "monopolistic" or "imperfect" that it is unreal, what then? If economics cannot rely on the competitive technique, what is to become of it? For example, it would seem to be impossible to get sufficient definiteness and *objectivity* without impersonal competition. If we are to rely on bargains and agreements, either the results will be indeterminate or they will be decided on some non-economic basis, say by judicial opinion or executive order.

The tendency to emphasize the monopolistic elements and imperfections in competition has aided both those who are critial of Neo-Classical economics and those who attack voluntary individual choice as a basis for economic values. Chamberlin's thought points to "waste" and Robinson's to "exploitation."[2] The general character of the analysis suggests control.

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[1] Moreover, differences among individual competitors are *changing*, and to eliminate time is unreal.

[2] Chamberlin differs sharply with Robinson on the point, holding that there is no "exploitation" either of labor or any other factor. His criticism of Robinson is acute and effective. (See *Monopolistic Competition*, 6th ed., pp. 182 f., 215 ff.)

CHAPTER XXXVI

VEBLEN AND INSTITUTIONALISM[1]

Institutional Economics, so called, is a phenomenon of the twentieth century. There have always been economic thinkers, who have taken an "institutional approach," and it would be hard to find any new ideas among the Institutionalists; but the seed for a new crop of "institutional" ideas was planted about 1899, in the shape of Veblen's *Theory of the Leisure Class*. It began to mature about 1914, when the same author's *Instinct of Workmanship* appeared, and three years later, one session of the annual meeting of the American Economic Association was largely devoted to a discussion of "The Institutional Approach to Economic Theory."[2] Meanwhile, the ideas of the sociologist, C. H. Cooley, concerning the nature of society and social processes, were attracting attention and were a factor in shaping Institutionalism.[3] And the pragmatic *Reconstruction of Philosophy* (1920) by John Dewey is to be noted as another factor.

After the World War I cataclysm, came the depression of 1921, and Veblen's *The Engineers and the Price System*. R. C. Tugwell soon edited *The Trend of Economics* (1924), in which a group, mostly young men having connections with Columbia, Harvard, or Chicago Universities, expressed their ideas. Finally, interest in Institutionalism came to a head in the depression of 1929–1933. The American Economic Association devoted a session to "An Appraisal of Institutional Economics" in 1931. Textbooks on *Economic Behavior*[1] and on *Modern Economic Society*,[2] appeared. By 1933, F. D. Roosevelt had become President of the United States, and brought with him to Washington as advisors several adherents of the "institutional approach."

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[1] Gruchy, A. G., *Modern Economic Thought: the American Contribution*, 1947, and bibliography (Gruchy shows prejudice in omitting several important Institutionalists.) Dorfman, J., *Thorstein Veblen and His America* (1934); *Amer. Econ. Rev.*, Vol. VIII, supplement, pp. 309–329 (1918), and Vol. XXII, no. 1 (1934); Tugwell, R. G. (ed.), *The Trend of Economics* (1924); Homan, P. T., *Contemporary Economic Thought* (1928), chapters on Veblen and Mitchell, and "The Institutional School" in *Encyclopedia of Social Sciences;* Burns, E. M., "Institutionalism and Orthodox Economics," *Amer. Econ. Rev.*, XXI, p. 80; Commons, J. R., "Institutional Economics," *ibid.*, p. 648; Copeland, M. A., "Commons's Institutionalism in Relation to Problems of Social Evolution and Economic Planning," *Quart. Jr. Econ.* (1936); Harris, A., "Types of Institutionalism," *Jr. Pol. Econ.*, 1932.

[2] W. H. Hamilton, J. M. Clark, W. W. Stewart, and W. F. Ogburn presented the case for Institutionalism. F. A. Fetter, B. M. Anderson, and L. H. Haney were among the critics.

[3] Cooley wrote *Social Organization* (1909), and *Social Process* (1918).

The "New Deal," as the Roosevelt administration came to be called, was greatly influenced by Institutional Economics. It may be classed as one of the outstanding cases in which a school of economic thought has been closely associated in a direct and practical way with government.

In short, "Institutional Economics," as here treated, is essentially an American product. Although it might have developed without him, it was largely influenced by the thought of Thorstein Veblen. Although almost entirely a movement in academic thought, for a time, say 1933–1937, it had great influence on government policies in the United States and therefore elsewhere.

General Nature of Institutionalism. — What, then, is Institutional Economics? Many differences may be found among those who are broadly classed as institutional economists, but the following statement of their agreements is illuminating:

(1) They believe that group "behavior," not price, should be the central theme of economics.

(2) They recognize that human behavior is constantly changing, and that economic generalizations should be relative to time and place.

(3) They emphasize custom, habit, and law, as modes of organizing economic life.

(4) They hold that important motives which influence individuals cannot be measured.

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[1] By Atkins, Edwards, and Friedrich.

[2] By S. H. Slichter.

(5) They assert that maladjustments in economic life are not to be regarded as departures from a normal equilibrium, but are themselves normal, — at least under existing institutions.[1]

In this statement, we see negative and positive sides, although the negative predominates. We see, first, a rejection of attempts to formulate laws deduced from human motives, and of the whole scheme of normal equilibria so highly developed, for example, in Marshall's thought. The "price system" economics would be abandoned. We see our old friends, the doctrine of relativity and the emphasis of habits and customs as elements in human choices. We see, secondly, more positive suggestions of "economic generalization" to be based upon uniformities in "institutions" (habits and laws), and looking toward an organization of economic life without reference to any theory of normal equilibrium.

It can be said without qualification that all the "institutional economists" regard human motives as largely instinctive, and criticize those economists who assume rational self-interest as a dominant motive. All center attention upon the institution (habits, customs, legal forms), regarding it as the chief factor in governing human behavior. Both the institution and behavior are regarded as phases of an evolutionary process, but the changes in the two are considered as non-synchronous. Accordingly, there is a tendency to see a need of eliminating maladjustments and clashes of interest, and therefore to advocate social control over institutions.

This last tendency, however, suggests an important line of cleavage in "Institutionalism." Some institutional economists are content to analyze and describe economic life, merely pointing out the maladjustments which they may see. Others promptly carry their findings into suggestions for action, and center Institutionalism around what they refer to as "the problem of control."

The foregoing difference in attitude, together with related differences, probably warrants us in distinguishing two general groups of Institutionalists: (1) The older or more negative group, including T. Veblen and W. C. Mitchell; (2) the younger or more positive group, including W. H. Hamilton, R. G. Tugwell, G. C. Means, W. E. Atkins, S. H. Slichter, and A. B. Wolfe. Professor J. M. Clark is in sympathy with much of the "institutional approach," but combines a leaning toward social control with good work along Neo-Classical lines.

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[1] This statement is based upon that made by Professor Willard E. Atkins, *Amer. Econ. Rev.*, Vol. XXII, no. 1, p. 111 (1932).

Professor John R. Commons,[1] while clearly an Institutionalist of a sort, antedates Veblen in the formation of his thought bent. If Veblen and most other Institutionalists may be thought of as "sociological," Commons may be thought of as "legal," since he deals chiefly with such legal concepts and forms as property, the corporation, and reasonable value.[2] His thought affiliations, however, suggest placing him in the group which seeks "control." S. Perlman appears to follow Commons.

The first group criticize the "value economics," but see little if any possibility of a science of economics. They incline to regard man as largely, if not entirely, an irrational bundle of instincts and habits. They confine themselves largely, if not entirely, to describing institutions and instincts, and their evolution, setting up no goals. They would let social evolution take its course. C. E. Ayres, however, although a close follower of Veblen and strongest as a *critic* of capitalism, attempts to construct an Institutionalist theory.[3] J. Dorfman may also be classed as Veblenian.

The second group, on the contrary, seek to replace "the old economics" with a new "evolutionary" science. They are logically forced to make more place for reason; for, seeing "control" through institutions as the great problem, they accept the task of appraisal and of setting up social goals. They would direct social evolution![1] As time went by, the younger group showed signs of disintegrating, till in 1947 the historian of the movement undertook to read Atkins and his New York University colleagues out of "Institutionalism" as being merely "descriptive" and not truly "holistic." Slichter, too, appears to have fallen from grace after 1924.[2]

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[1] *Legal Foundations of Capitalism* (1924); *Institutional Economics* (1934).

[2] In his *Institutional Economics* (p. 4), Commons, in referring to intangible property, states that Veblen's notion of such property led him to "the Marxian Extortion and Exploitation." His own notion leads him (Commons) to "the common-law notion of reasonable value."

[3] *The Theory of Economic Progress*, 1944.

To the foregoing may be added K. Polanyi, whose *The Great Transformation* (1944) suggests that individual freedom is an illusion, attacks the capitalist market system, and defends interventionism. Paradoxically, the basic assumption is that man tends to resist change!

There is thus a considerable resemblance between the American Institutionalists of the 1914–1946 period, and the German Historicists of the 1843–1872 period. Without attempting to point out similarities in the troubled times which characterized both periods, we note first that Historicism in general has resemblances to Institutionalism in general. Both emphasize the importance of the institution, and stress the principle of relativity. Both emphasize change, and evolution of some sort. Both vigorously attack the Classical economics on the ground of its dogmatic deductions from abstract and unreal assumptions, and especially its "mechanical" individualism and self-interest motivation. Both seek realistic descriptions of human behavior. The Austrian School attacked the Historical School; the Institutionalists attack the Austrian!

The difference is that the Historicists were more largely interested in the question of logical method. They were also more ready to accept the existence of positive economic law in a provisional way, and for a given time and place. They, on the whole, had less of an idea of evolution in the Darwinian or Spencerian sense. In these respects, at least, the Institutionalists differ from the Historicists — to say nothing of the Veblenian terminology.

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[1] Naturally it is this group which influenced the policies of the "New Deal" under F. D. Roosevelt's administration.

[2] Gruchy, *Modern Economic Thought* (see Index under "Atkins" and "Slichter").

But even the distinction made between the "older" and the "younger" groups points to a similarity. The older German Historicists were, like the older Institutionalists, less confident of revolutionizing economics and establishing a new science. They were also less given to reforms than the "younger" ones. And the "younger" groups in both schools at first sought to establish a new economics, and became associated with social reform movements. This similarity should not be overworked; but it has its significance.

Veblen. — Thorstein Veblen[1] (1857–1929) was an eccentric person of great erudition. Interested primarily in philosophy, psychology, and sociology (especially ethnology), he was so impressed with the shortcomings and errors of the economists of his day, that he chose to write chiefly on matters pertaining to economics. He taught in the departments of economics of several American universities.

Economics, he held to be fundamentally unsound. He attacked it primarily, though not solely, upon two grounds: its hedonistic psychology, based upon the pleasure-and-pain calculus; and its assumption of a "meliorative trend," whether based on divine guidance or a harmony of self-interests. Both attacks are almost as old as economics. Many others had criticized optimism, nature philosophy, etc. Veblen, however, usually develops a peculiar terminology, and a part of his prestige comes from a cult-like use of words.

He conceived of an "evolutionary economics," although, with a characteristic touch of cynical irresponsibility, he seems to have doubted its possibility. Be that as it may, he produced an analysis of instincts and institutions, the essential features of which appear in *The Instinct of Workmanship,* which others have sought to make the basis of a new economics. Stripped of Veblen's terminology, the idea is that a few characteristic human predispositions, or "instincts," condition and determine man's survival and development, and play a predominant part in his current life. (Physical environment is mentioned, but plays little part in the discussion.)

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[1] *The Theory of the Leisure Class*, 1899; *The Theory of Business Enterprise*, 1904; *The Instinct of Workmanship and the State of the Industrial Arts*, 1914; *The Vested Interests and the State of the Industrial Arts*, 1919; *The Engineers and the Price System*, 1921; *Absentee Ownership and Business Enterprise in Recent Times*, 1923.

But reason, which provides the means that implement instincts, gives rise to expedients and adaptations which become fixed as habits or customs. These are "institutions." These persist, and by cumulative growth become a large part of man's environment. Veblen's thought is therefore centered upon the institution, its origin, and evolution, and its reaction upon man. It may suppress or even modify instincts. The reason, which provides the institution, seems powerless to readjust it.

Thus institutions may and do fail to keep in adjustment with current experience. A "cultural lag" results, with strains and clashes of interest.[1]

The chief economic institutions, to Veblen's mind, are property (which he associates with acquisitive and predatory activities), and technological methods (which he associates with production proper). In these, economic life, regarded as a process, centers. Originally, technological information was open to all, he assumes; but as the industrial arts develop, production comes to exceed necessities, and property rights are then used by predatory groups to enable them to seize the surplus and live in leisure. Self-interest then clashes with the common good, and personal, money-making motives dominate impersonal motives to "effective serviceability." "Futile effort" grows at the expense of "effective work."

Machinery comes under the control of moneyed interests, who run industrial establishments as absentee owners, making profits by restricting production, by price fixing, and by financial manipulations in which credit plays an increasing part. They overcapitalize, in anticipation of speculative earnings. Business crises are a result.

A fundamental class conflict exists: the conflict of interest between all who work in a socially productive way and all who live acquisitively and who, though directing the technique of production, constitute the "leisure class."[1]

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[1] Cf. with Marx above, p. 487.

Veblen sees life as endless change, with no known beginning and no known goal — and without any stopping points which can be regarded as worthwhile levels of equilibrium. He was greatly influenced by the Darwinian idea of evolution and by biological research (e.g., that of Loeb).

While, therefore, his thought has resemblance to that of Marx, he did not, like Marx, have the Hegelian notion of a thesis and an antithesis, with a final synthesis in the shape of a definite set of social institutions.

Other Institutionalists. — W. C. Mitchell (1874–1948), who knew Veblen well, also stressed the irrationality of human action, and accepted "instincts" — perhaps meaning habits — as the prime movers and determinants of human ends. He thought of economics as the study of human behavior, embracing all sorts of concrete-historical research as well as theoretical work. He stressed statistical research, and is well known for his painstaking studies of "greenbacks" and "business cycles."

In his presidential address before the American Economic Association, he said in 1924: "If our present beliefs are confirmed, that the human nature which men inherit remains substantially the same over millenniums, and that the changes in human life are due mainly to the evolution of culture, economists will concentrate their studies to an increasing degree upon economic institutions, — the factor which certainly admits of change and perhaps admits of control."[2] The "if" and the "perhaps" are characteristic.

Aside from monographic studies about particular "institutions," however, it remained for younger men to attempt to found the "evolutionary science" dreamed of. W. H. Hamilton compiled a case book for teachers, and made a study on the control of wages.[1] R. G. Tugwell edited a series of theoretical essays by sympathizers with the "institutional approach," and as joint author published a survey of American economic life and the means of its improvement.[2] Finally in 1931, came Atkins' (and others) *Economic Behavior*, and Slichter's *Modern Economic Society*, both textbooks which attempt a restatement of economics from the point of view and according to the method of Institutionalism. The former deliberately omits discussion of the determination of value and distribution according to utility and cost, but "describes" business enterprise, savings habits, and the behavior of buyers and sellers. The latter endeavors to "restate economics" as a description of the "realities" of modern industrial activity, giving large space to monopoly and to public authority, and ending with the "suggestion" of a National Economic Council for planning and stabilization of business.

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[1] Compare the three preceding paragraphs with Marx's views as outlined on pp. 487–489, above.

[2] *Amer. Econ. Rev.*, Vol. XV (1925). At times Mitchell seems to lean more decidedly toward the more positive "control" group. In Tugwell's *Trend of Economics*, he says: "In economics as in other sciences we desire knowledge mainly as an instrument of control. Control means the alluring possibility of shaping the evolution of economic life to fit the developing purposes of our race" (p. 25).

In the post-Veblenian period since about 1930, beginning with the great depression, the younger Institutionalists may be grouped as (1) the historico-behavioristic group represented by Atkins and his colleagues at Washington Square College, N.Y.U., and (2) the experimental approach and social planning group represented by Gruchy and Ayres. The second group, which is bent on extending social controls, breaks down into (*a*) the idealists who may be called "holistic," in whose organismic thought may be seen some affinity with Fascism; and (b) the materialists who, carrying on from where Veblen stopped, dwell upon the "social heritage" and property rights, and whose thought suggests Marxian economics.

In the foregoing discussion, Institutionalism has been dealt with as an American phenomenon, stemming from Veblen and Commons. But its similarity to certain attitudes and doctrines of the German Historical School has been observed; and it is further to be noted that other developments in European thought exist which might have been called "Institutionalism" had they occurred in America. Thus Spiethoff's approach to economics resembles Mitchell's, and his attitude toward cycles was similar. In 1908, came Sombart's conversion to the idea that value judgments are impossible in economics, which had considerable influence. Outstanding are certain movements in German thought the early phases of which may have touched Veblen. Particularly notable are the socio-legal studies of R. Stammler, R. Stolzman, K. Diehl, and to some extent Amonn. The last name suggests, too, the study of "power" (*Machttheorie*) as a social factor distinct from economic values, and the significance of the legal order as limiting economics has been much discussed by such well-known economists as Kaulla[1] and Zwiedeneck-Südenhorst.

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[1] *Current Economic Problems* (1914); *The Control of Wages*, Hamilton, W. H., and May, S. (1923).

[2] *The Trend of Economics*, edited by R. G. Tugwell (1924): *American Economic Life*, Tugwell, Munro, and Stryker (1925).

In general, it is to be remembered that socio-legal factors have long been emphasized by certain groups of economists both in Germany and Italy.

General Appraisal. — With the doubtful exception of Veblen, no one taking the strict "institutional approach" has added anything material to the body of economic science. The position again resembles closely that of the Historicists and such early Institutionalists as Richard Jones, Leslie, Toynbee, and John Rae. Valuable criticisms have been made, which may have somewhat modified the course of economics. Worthwhile descriptive studies have been embodied in monographs. But, though proposals looking toward a new "evolutionary economics" are announced, these remain as projects. After all, what in their thought is not negative, is either not new, or is not economics in the sense of science. It remains for the "Institutionalists" to produce their Adam Smith or their Ricardo — or even their von Thünen or Jevons. In economic thought, this is not a day of beginnings.

As critics, however, the Institutionalists have done excellent work. Negatively, they have reinforced the valid criticisms of Classical economics, and have brought them home to Neo-Classicism. They have exposed, in others, various unreal assumptions and an excessive use of abstract-deductive methods, and they have demonstrated the limitations of economic "laws." Positively, they have emphasized the part played by the institution, have presented useful analytic descriptions of institutions, and have, by demonstrating the importance of irrational motives, corrected an imperfect construction and use of demand and supply schedules. Their emphasis of evolution, and the relativity of contemporary culture, if not new, was needed, and has been helpful.

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[1] See *Theory of the Just Price*, 1940 translation from German work of 1936.

What, then, as to constructive work? Economics has been developed as a body of laws which can be definitely and positively formulated. These laws are mostly "provisional" and subject to the assumption of "given conditions"; but they are none the less scientifically valid, and are practically *useful.* What would the Institutionalists put in their place?

Among the weaknesses of Institutional thought, with especial reference to Veblen and his followers, we may list the following.

It contains elements of abstractness, and makes unreal assumptions, which render it unsatisfactory to the scientist. It begins with the assumption of certain "instincts," and reduces man ("human behavior") to these, and certain "habits." The Institutionalists do not and cannot prove that their kind of "economic man" is real. "Generic instincts" — largely man himself — are supposed to remain unchanged, after being fixed thousands of years ago. Their economic man is assumed to have a taste for "effective work" and a distaste for "futile efforts." This "originally" simple creature *naturally* (Veblen would say "generically," or use some other just-as-good word — perhaps "tropismatically") is led by the unseen hand of instinct to prefer the common good!

With a vicious abstraction, they ignore or slight reflective choice and much of sentiment. It is no more true that "man" is a mere creature of habit than that he is a hedonistic calculating machine.

There is much naïve question-begging in the use of words, such as "effective," "serviceable," "workmanlike," "futile"; and there is even some talk of the "purposes of our race." How do they know the criteria of "effectiveness"? What purpose lies in impulses and habits?

Much of the Institutionalists' thought leads to the adoption of the test of "survival." This is not only a strongly materialistic concept, but is vague. What *is* "survival"? Is one survival as significant as another?

Veblen, at least, is full of a Veblenesque hedonism, which runs, not in terms of pleasure and pain, but in terms of "effectiveness" and "futility," and which works, not rationally, but irrationally — though just as mechanically, it would seem.

With much abstraction and unreality, their thought naturally contains important deductions which cannot be verified. Thus they sometimes (not always) reason from early evolutionary stages to contemporary institutions. It seems as erroneous, however, to seek the significance of existing culture by reference to early customs, as it is to take what we find around us for granted without any historical study. *There is danger that the significance of existing institutions with reference to existing life, may be overlooked.* Even a process of "rationalization" may be justified, and it certainly must be explained. The test of survival is a two-edged sword.

Tacitly, they often assume that present conditions are undesirable or bad, and this for "reasons" which they arrive at by a process of deduction. They assume that "institutions" are the cause, and that by changing them, the conditions can be remedied. They, in short, are homeopathic and empirical. But evidently there underlies all this, a premise to the effect that they know what changes to make, or that they can find out by "the experimental approach" — either that, or the assumption of a contingent "meliorative trend," to be made effective by removing certain obstacles.

By their exaggeration of endless qualitative changes, they seem to be estopped from seeking positive laws; and by their acceptance of no goal, they should be estopped from formulating normative laws. A goal-less evolution seems to lead to a sort of *laissez faire* — let institutions evolve! It seems to provide no basis for stopping and dealing with conditions as they are now and now, and one can understand Professor Slichter's lament, that he must always be behind his "Modern Economic Society." If they "reconstruct economics in terms of contemporary culture," they will ever be historians!

Their thought suggests a sort of "kinematics," to the extent that they conceive of economics as dealing with ever moving bodies governed by no causal forces and tending toward no equilibrium. They can undertake to *describe* life in such terms (although the reality of the description may be doubted), but they cannot *explain* it. Thus they not only deny the validity of economic laws, but some of them deny the existence of such laws.

If, however, they undertake to ascertain *laws of change*, as some of the talk about "evolutionary economics" suggests, they will either fail as the earlier Historicists failed, or will develop a Neo-Classicism of their own, with "normal" rates of change, and equilibria among evolving forces.

The relation between "instincts" and "reason," and the part played by "institutions" are not all clear. And what about the physical environment? The Institutionalists either assume certain innate emotional tendencies or they accept "behavior" as they see it. These assumed elements in man determine either goals or goal-less changes. But somehow, "reason" creeps in, and "contaminates" instinct.

Now if reason can do so much, why not more? If instincts, physical environment, and "reason" remain constant, why the endless change? Above all, why the fatal "cultural lags"? Why does reason not keep an adjustment and prevent maladjustment? Why does the "institution" become a sort of Frankenstein?

Something of these difficulties is seen in the attitude toward "experiment" and "control." The younger or more positive Institutionalists put control in the center of their scheme, and then proceed to experiment! They regard institutions as agencies of control, but lacking any principles based on causal forces, and professing ignorance or uncertainty as to goals, they do not know how to control. They say we will experiment!

But how can they tell when an experiment has succeeded? What are their criteria of success? We find no answer. The test of technological efficiency merely leads to the futilities of "Technocracy." A sort of planless planning is the result, with the law of supply and demand defeating experiment after experiment.

How do they know what institutions are "good" and what are "bad"? And how do they know that institutions are the cause of evil — rather than "instincts"?

The logical difficulties in which they find themselves involved, drive them to take the emphasis off "instincts," in any usual sense of that term, and to regard them as virtually replaced by "institutions" defined as social habits. This seems to make their logic more consistent, but more meaningless, and it leaves their sort of "economic man" so denatured and unreal that he cannot stand up.

In fact, their quest for "instincts" that will not destroy their institutional experiment leads them to talk of "the social innateness" of instincts — instincts "conditioned by culture" — in a way that indicates a tendency toward an organismic concept of society, a "social mind," and all the errors and unrealities which such thought has always revealed, whether in Romanticist Nationalism, in Socialism, or in static marginalism.[1]

Any control through institutions, which they assume to be ever "lagging," must either be futile, because too late, or be limited by the weakness of reason — the lack of principles and plans. Any reasoned plan must rest upon the assumption of (1) uniformities, and (2) a goal or objective. It involves the concept of either an equilibrium or a norm.

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[1] Cf. Müller, Schäffle, and J. B. Clark, respectively.

In specific criticism of Veblen as a contributor to economic thought, it can be said that mostly he presents old criticisms in new words. In so far as his words express his ideas, his "instincts" are poetic rather than scientifically determined. His analysis of the economic system of his time was, at best, but partial, failing to describe and analyze it adequately in the light of the contemporary culture. He makes such abstract assumptions as that "workmanship" is always equivalent to the "common good," and that property and money and profits are not conducive to workmanship. He works up to the idea of an inevitable class conflict, and then lacks the powers, or the sincerity, to deal with it.

Implicit in his thought, as in that of some of the other Institutionalists, is a glaring failure to see the significance of objective economic values, as a means of balancing human desires and aversions (utility and cost). The whole episode of "Technocracy" illustrates this, and the talk of an "economy of abundance" which arose involves a conflict of terms. Technological production must be governed either by (1) individual choices and the relative importance of things as determined in "markets," or by (2) some sort of dictatorship. The former leads, or can lead, to a scientific approach, which, while it does not eliminate experiment or reject all guidance, enables explanation in terms of proximate causation. The latter involves a reliance upon the intuitions of some individual "leader," and a large amount of coercion.

Economists should never forget that economics is not a defense of prevailing institutions. It is not a defense of any institutions.[1] It deals with desires, and the factors and functions which these have occasioned through production and consumption — with capital in Russia, or with enterprise in a "coöperative" organization, just as well as in some "capitalistic" society. These it seeks to explain and to appraise from the point of view of a definite criterion, "economic value." It asks, what are things worth to individuals living together in society? In humbly seeking the answer, it finds important physical limitations and costs, which differ according to individuals and location. These enter the problem of determining not only what men do, but what it is worthwhile to do. Let the Institutionalist describe our institutions — even let him change them — but let him not forget such laws as supply and demand, diminishing utility, and diminishing returns. The laws of economics work through institutions, but they are more fundamental than institutions.

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[1] Incidentally, it should be noted that "institutions" differ in their relation to man. "Property," for example, has a content which to an uncertain extent bases upon the individual and his assumed instinct for workmanship.

CHAPTER XXXVII

KEYNES AND HIS POLICIES[1]

The preceding chapters have mostly dealt with "micro-economics" — economics concerned with the determination of *particular* prices or values. Now comes a chapter which deals with "macro-economics," or national *aggregates* in the shape of total national income as affected by total spending or not-spending. In micro-economics, the basic idea is of more or less automatic *equilibrium* among particular values, prices, or payments, departures from which — perhaps cyclical in nature — are more or less temporary maladjustments. But in macro-economics, the thinker is concerned directly with the aggregate income and with its *flow* through the body politic in the channels of spending.

The one is concerned directly with cause-and-effect analysis of individual choices (value economics) or preferences (price economics); the other directly with *policies* affecting some aggregate result such as maintaining the total income and its flow, or the full employment of aggregate resources.

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[1] *Keynes's chief writings: Indian Currency & Finance*, 1913; *The Economic Consequences of the Peace*, 1919; *A Treatise on Probability*, 1921; *A Tract on Monetary Reform*, 1923; *The End of Laissez-Faire*, 1926; *A Treatise on Money*, 2 vols., 1930; *Essays in Persuasion*, 1931; *The Means of Prosperity*, 1933; "National Self-Sufficiency," *Yale Rev.*, 1933; *The General Theory of Employment, Interest, and Money*, 1936; "The General Theory of Employment," *Quart. Jr. Econ.*, 1936–7, pp. 209–223; *How to Pay for the War*, 1940.

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Cortney, P., *The Economic Munich*, 1949.

This chapter deals with the thought of Keynes.

Ordinarily the historian would hardly devote a whole chapter to one whose work had ended so recently, especially one whose effective theoretical work came only ten years before his death. But much the same could have been said of David Ricardo, and Keynes's influence grew so rapidly even in his own lifetime that special consideration seems justified.

Keynes's Life and Background. — John Maynard Keynes (1883–1946) was the son of a well-known English economist and Cambridge University professor. He was trained in Marshallian economics, and after two years, 1906–1908, as a government employee (in the India Office), he taught such economics for twenty years, to 1929.

In 1911, he succeeded Edgeworth as editor of the *Economic Journal*, which strategic position he occupied until just before his death. About the same time, he became Secretary of the Royal Economic Society.

In 1915 he entered the British Treasury, and worked there till shortly after the close of World War I, resigning in 1919.

Soon after resigning from the Treasury, because of disapproval of the government's financial policies, Keynes entered various business arrangements such as an interest in *The Nation*, an office in an insurance company, and the management of an investment trust. In these capacities, he succeeded and made money.

Thus Keynes was a Cambridge-trained student and teacher, a government official, an editor and secretary of a scientific association, and a businessman. But all the time, he was an economist — one who was constantly concerned with the economic problems of his time and place.

This was an extraordinarily troubled time and place. Judging by Keynes's record prior to 1919, one would be justified in concluding that, but for the war and its aftermath, he would probably have appeared as a fairly stable person, perhaps even undistinguished. As it was, he is seen as changing, unstable, brilliant, certainly distinguished, and a leader.

And it is important to add that Keynes had a personality such as attracted and held a sufficient following to multiply his influence.

Prior to World War I, Keynes did nothing to attract world attention.[1] Then he participated in handling the problem of financing the war, and thus came to confront in a more significant way the problem of financing peace. Here his tendency to be different showed itself: He opposed the Treasury policy, resigned, returned to King's College, and published his *Economic Consequences of Peace* (1919).

This work was well timed, and attracted widespread attention, mainly as the result of his attack on the peace terms and German reparations. These he argued could not work. As the essential correctness of his pessimism became apparent, say by 1931, he became famous as the leading representative of a widely accepted forecast.[2]

But little attention appears to have been paid at the time to the kind of economic theory which lay back of Keynes's views on policy. This theory included the idea that saving is merely a bourgeois habit, and that capitalism is nearly through and has entered a declining state. Thrift, he said, is to say the least, often inexpedient. It feeds on an unequal distribution of wealth (which, therefore, is by implication, also inexpedient).

In the first post-war period, 1918–1930, came the realization of the war debt burden, the struggle with trade dislocation, unemployment, and effective inflation. These problems brought a logical development in Keynes's economic thought, based as it was mostly on the premise that monetary controls, implemented by a manipulation of interest rates, would provide the best national policy. Keynes advocated the capital levy and lower interest rates, as means of lightening the public debt burden; but he argued that it would be unwise to repay the debt.[1] (It is interesting to conjecture how much his later theory concerning capital formation and interest was influenced by these practical problems.) At the same time, he agreed, England must do something to restore her trade and regain a favorable balance of payments, and to this end he advocated such controls as had been used during the war to hold export prices down and to regulate exchange rates. This advocacy he based on a theory of monetary policy for "control" purposes, and, at this time, he accepted without essential qualification the so-called quantity theory, with emphasis on the velocity factor.[2]

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[1] He published a book on *Indian Currency and Finance* in 1913, after lecturing on that subject in the London School of Economics, 1910–1911. Even at this time some tendency to favor a "managed" monetary standard appears. But he usually accepted the gold standard down to 1923.

[2] E. Mantoux in his *The Carthaginian Peace, or the Economic Consequences of Mr. Keynes* (1946) shows that World War II disproved Keynes's contention that the most serious problem was financial and economic, not political and territorial; also that Keynes failed to foresee that Hitler would rise to control and prevent chaos.

As the inflation became effective in rising prices, a conflict of ideas arose between those who favored deflation and those who favored further inflation. Some wanted a return to the gold standard, and to lower prices and wages. Keynes, however, argued for inflation, and against the gold standard, at least on the basis of pre-war parity.[3]

Between 1923 and 1931, Keynes wrote frequent articles on unemployment. But as to wages, his thought does not seem so clear. Apparently he favored lower money wages, since he argued that labor would have accepted a reduction if laborers had not thought that a cut would merely have gone through higher interest to benefit the bourgeois saver, Keynes's rentier class — his pet aversion. He did not like the Labor Party any more than the Conservatives. Later, he was to suggest that by inflation the real wages of laborers could be reduced without resistance on their part. And at the beginning of World War II, he proposed "forced saving" to labor, as a means of avoiding higher prices. But it does not seem that he favored a mere cutting of wages in order to restore England's export trade.

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[1] See Keynes's testimony on the capital levy before the Committee on National Debt and Taxation, *Minutes of Evidence* (1927), II, pp. 534–540.

[2] *Tract on Monetary Reform*, 1923.

[3] *The Economic Consequences of Mr. Churchill*, 1925. While somewhat conflicting remarks may be quoted, Keynes may be said to be rather consistently opposed to the gold standard from this time on.

This theoretical background appears in his *Treatise on Money*, 1930, probably the most ambitious attempt at pure economic theory Keynes made. In it, plainly showing the influence of Wicksell and Hobson (as well as certain concessions to Marshall's thought), he emphasized the importance of the interest rate, and argued that private saving is apt to have undesirable effects, partly because it is separate from investment decisions. Money he considered as representing all economic activity.

In 1925, England returned nominally to a gold standard at pre-war parity. But the attempt at deflation on this basis soon failed, and a brief period of inflationary prosperity ensued. Without following Keynes's technique of monetary manipulation, England and most other nations went on inflating. Thus Keynes saw more of the speculation which he, like most economists, came to deplore if not detest. He supported a program of public works in 1929. From 1925 to 1931, however, he appears as little more than a monetary reformer seeking lower labor costs to help Britain's trade.

Then came the big depression of the thirties. Keynes, who had by this time become pessimistic, saw in it the long-run results of those conditions of which he disapproved, especially private saving to which he attributed unemployment. His thought developed along the line of the futility of paying interest for money, which he now regarded as credit, and the desirability of a managed fiat currency. In this period, following 1930, it may be said that Keynes came to oppose saving and attribute interest to mere "liquidity preference," and to see England's depression as a condition of long-term "stagnation," to be combatted by lower interest rates, devaluation, and the socialization of demand.

It remains to note the growth of Keynes's interest in the economy of the United States. This seems to have become important about 1931 with his discussion of the causes of world depression. Then came his 1933 article on "National Self-Sufficiency" in the *Yale Review*, and his open "Letter to President Roosevelt" in the *New York Times*, Dec. 31, 1933; and he began to write about "Mr. Roosevelt's Experiments," the "progress of the United States," "President Roosevelt's Gold Policy," etc. Keynes visited Roosevelt in 1934.

Two general results stand out: (1) Keynes's doctrines soon came to exercise great effect upon American policies, tending toward what he called "our own favorite experiments towards an ideal social republic" in the form of a nationalistic managed economy; although it was not till the recession of 1937–38 that Roosevelt fully accepted Keynes's scheme of deficit-spending for stimulating recovery.[1] (2) Keynes's doctrines gained in influence by their adoption in the United States. It may also be said that (3) Keynes's detestation for what he called "individualistic and decadent capitalism,"[2] and his aversion toward competition and stock market speculation were heightened.

Keynes's Position in the Stream of Economic Thought.— While Keynes retained certain Classical doctrines, and did not attack Classicism so much as he did certain contemporary economists (such as Pigou) supposed to represent it, his basic approach to economics is fundamentally different from that of Classical economics. Classical economics was based on the price system and on a presumption in favor of the efficiency of private enterprise. It emphasized the problem and real costs of production, including time costs. Keynes's *General Theory* differed widely in these respects.

First, one notes that his thought is in line with the writings of many recognized opponents of the Classical economics— Lauderdale, Sismondi, Rae, Proudhon, Marx, and Hobson, for example. The "unorthodox" views of Malthus concerning underconsumption are in point.

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[1] Smithies, A., "The American Economy in the Thirties," *Papers and Proceedings of the Amer. Econ. Assoc.*, 1946.

[2] "National Self-Sufficiency," *Yale Review*, 1933.

Also we find Keynes himself commending and adopting ideas of contemporary "radicals" such as Gesell. And it has some significance that Keynes's doctrines have in turn been commended and adopted by a good many contemporary radical thinkers.[1]

Keynes's thought is similar in several respects to exactly those "schools" of economics which Adam Smith undertook to overthrow, Mercantilism and Physiocracy. It has already appeared that his thought led to Nationalism and the emphasis of money. More than this, he cited with approval the leading Mercantilist writers, to whose doctrines he devoted 17 pages of the *General Theory.* The general idea is to show that, contrary to Classical economists, the Mercantilists understood that the state should supply inducements to invest, by means of low interest rates and wages,[2] and a favorable balance of trade, to which means they more or less wisely advocated such devices as usury laws, devaluation, and protective tariffs. And the central thought is that "as a contribution to statecraft, which is concerned with the economic system as a whole and with securing the optimum employment of the system's entire resources, the methods of the early pioneers of economic thinking in the sixteenth and seventeenth centuries may have attained to fragments of practical wisdom which the unrealistic abstraction of Ricardo first forgot and then obliterated."[3]

Certain commentators, notably Rist, have also pointed out similarities between Keynes and the Physiocrats, mentioning Cantillon, Quesnay, and De Nemours. The treatment of the aggregate income of the nation, the circular-flow idea, and the undesirability of interrupting this by saving (not-spending) are important points of resemblance.[4]

Others have noted the resemblances between Keynes's thought and Socialism or Communism, mentioning Proudhon and Marx.[1]

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[1] E.g., L. R. Klein, A. P. Lerner, Joan Robinson (*An Essay on Marxian Economics*, 1947).

[2] Cf. *General Theory*, p. 340. Keynes says "by discouraging rises in the wage-unit."

[3] *Ibid.*, p. 340.

[4] See Gide-Rist, *A History of Economic Doctrines*, p. 739.

To the historian, however, probably the most important fact is Keynes's relation to a long line of economic writers who have attacked "saving" as tending to cause underconsumption and depression. These have all been opponents or critics of the Classical economics. Beginning with Lauderdale, Sismondi, and Malthus, the list runs through Chalmers, W. H. Crocker, and J. M. Robertson, to J. A. Hobson and Major Douglas[2] in England, and Foster and Catchings in the United States.[3] Silvio Gesell was also a factor in Keynes's thought.

Special mention is to be made of Hobson's influence. His notion of "underemployment," caused by an "undue exercise of the habit of saving" is adopted by Keynes, who quotes the earlier writer at length in the *General Theory* "to show how significant and well-founded were the author's (Hobson's) criticisms and intuitions."[4]

And there is also an interesting line of thinkers who developed ideas about money and credit, in conflict with Classical thought. Among these may be listed, in order of time, Hermann (1832), H. D. Macleod, Irving Fisher,[5] Gesell,[6] Hawtrey, F. Soddy,[7] and Foster and Catchings[8] in English, and A. Hahn[9] and Lederer in German. These men and others developed and spread the idea that money is credit, and that credit requires no objective standard. Cutting loose from technical aspects of production and consumption, they dealt with values as prices, determined by "reciprocal demand." Some even went so far as to treat credits as an addition to exchangeable objects, not as mere offsetting claims against wealth. Several of the foregoing also emphasized the lack of correlation between saving and investment, and held that interest payments merely serve to equalize credit and investment. With these ideas, Keynes's thought shows considerable affinity.

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[1] Klein, L. R., *The Keynesian Revolution*, 1947, pp. 78, 185 f.; Dillard, D., "The Pragmatic Basis of Keynes's Political Economy," *Jr. Econ. Hist.*, 1946; Robinson, J., *An Essay on Marxian Economics*, 1947.

[2] See Keynes, *G. T.*, pp. 370–371.

[3] For an admirable discussion see Fetter, F. A., "Lauderdale's Oversaving Theory," *Amer. Econ. Rev.*, 1945.

[4] *G.T.*, pp. 365–366, Keynes refers to Hobson's and Mummery's *Physiology of Industry*, 1889. His praise of Hobson's thought has not been widely shared by economists.

[5] Keynes reviewed Fisher's *Purchasing Power of Money* in *Ec. Jr.*, 1911. Fisher's theories were discussed in the *Economic Journal* by Robertson in 1934. Keynes gives Fisher credit for presenting the marginal-efficiency of capital idea in 1930 (*Theory of Interest*).

[6] *The Natural Economic Order*, German, 1916, English, 1930.

[7] *The Role of Money*, 1935; *Money versus Man*, 1933. Soddy refers to Gesell and Fisher.

[8] *The Road to Plenty*, 1928. See D. H. Robertson, "The Monetary Doctrines of Messrs. Foster and Catchings," *Quart. Jr. Econ.*, 1929.

[9] Hahn changed his ideas with the 3d edition of his *Volkswirthschaftliche Theorie des Bankkredits* (1924), and became a severe critic of Keynes. See Hahn,

Contemporaries. — Keynes's thought, like that of the limited-competition theorists, was affected by Marshall's "Neo-Classicism."[1] On the positive side, one may say that, by his lapses into "price economics," Marshall suggests an emphasis on the *rate* of interest which tends to put funds in place of capital goods. One may find suggestions of depreciation as being, in part, Keynes's "user cost" — an opportunity-cost notion. Marshall suggests some gaps between income and spending. His thought occasionally relies upon "expectations" in connection with the uncertainties of the future. In general, his treatment of money and of time opens the door to Keynesian doctrines.

But equally important were the negative suggestions that came from Marshall's assumptions and oversimplifications.

L. Albert, "Deficit Spending and Private Enterprise," Post-war Readjustments, Bul. No. 8, U.S. Chamber of Commerce. "As those who are familiar with modern literature on economics know, in my book *Volkswirtschaftliche Theorie des Bankkredits* (Economic Theory of Bank Credit) as early as 1920 I set forth the essential ideas of Keynes, including the idea of eternal prosperity through monetary and credit manipulations and the idea of liquidity as being rewarded by interest payments; a fact which, by the way, has never been mentioned by Keynes or his closer followers. My statements were made at that time against the nearly unanimous opposition of orthodox economic thinkers, who called me a modern John Law and charged my theories as being a relapse into a pre-classic state of thought when the distinction between capital and money was not yet clearly established. As a matter of fact, as I put it once in a criticism of Keynes, 'All that is wrong and exaggerated in Keynes, has been said much earlier and much clearer by myself.' Generally speaking, I do not feel very happy to see my early ideas so widely accepted under the influence of Keynes and his school."

[1] See Keynes's references to Marshall in his *General Theory*, pp. 19, 20n., 32, 37, 56, 72, 140n., 177, 184, and 186–190.

Among these, one finds that Keynes shows the clearest reaction to the assumptions that all income is spent, and that the aggregate of savings equals investment. Outstanding was the effect of Marshall's oversimplification of the determination of interest rates, and of the part played by interest in equalizing saving and investment. His weakness in handling marginal productivity was also noted by Keynes.

At this point, reference should be made to Keynes's clash of ideas with Pigou, particularly concerning the relation between wages and employment. Professor Pigou, Marshall's successor at Cambridge, made some concessions to unorthodox ideas concerning credit and interest, and the relation of saving to the accumulation of capital.[1] To these, Keynes refers. But the main point is that Pigou in his *Theory of Employment* (1933) undertook to defend the Classical position that reductions in wages tend to bring about full employment.[2] This position Keynes and his group vigorously attacked, as will appear on a later page.

Other contemporary influences were the London School of Economics and the younger Cambridge group. King's College is in London, and Keynes taught for a short time in the London School. This school was founded largely to counteract Classical economics. Its emphasis on institutional factors and on Socialism seems likely to have had some effect upon Keynes.

But much more important was the influence of his associates, mostly at Cambridge. Keynes himself acknowledges a heavy debt to D. H. Robertson, and refers to "constant advice and constructive criticism" received from R. F. Kahn,[3] as well as much help from Joan Robinson, Hawtrey, and Harrod. The notable 1933 debate in the *Economic Journal* on the relation between savings and investment, in which Hawtrey, D. H. Robertson, and Harrod participated along with Keynes, must have contributed much to his thought. As an independent thinker, both criticizing and contributing, D. H. Robertson deserves special mention.[1] From 1926 on, he did work in the field of "dynamic" economics, in the course of which he departed from assumptions that saving equals investment, or that a decision to abstain is a decision to invest. And he both emphasized money spending as a stimulant and held a loanable-funds theory of interest.

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[1] *Economics of Welfare* (1912), 3d ed., p. 63, and *Theory of Industrial Fluctuations* (1927), pp. 251–253.

[2] By 1945, in *Lapses from Full Employment*, Pigou had adopted a less extreme position: that under stable conditions, apart from frictions and immobility, and assuming thoroughgoing competition among laborers, full employment would result, except in "very unlikely circumstances" (p. 25).

[3] Kahn's article on "The Relation of Home Investment to Unemployment" in *Ec. Jr.* (1931), is erroneously given credit by Keynes for originating the concept of the multiplier.

In all this, too, one should not forget the part played by Wicksell, Cassel, and the Walrasian theories upon which the Swedish economist drew. Wicksell taught that consumption is definitely related to income, and his ideas on interest, saving, and investment influenced both Keynes and Robertson. Cassel's anti-Classical monetary economics and attempt to formulate a general equilibrium theory in monetary terms were known to them. Keynes several times refers to both in his *General Theory*.

It remains to note that Pareto and Wicksteed both had come to reject Classical economics, and that the former is one who, having *eliminated time* from his economic theory, found no real part left for capital. While Keynes does not refer to these well-known economists in his *General Theory*, one cannot but suppose that he was well acquainted with their thought.

KEYNES'S SYSTEM OF ECONOMIC POLICY[2]

The Underlying Assumptions—*Consumption Economics.*—The first thing to understand is that Keynes made consumption the primary element in his economic thought, in general putting it ahead of production.[1] His system may be said to be based upon "utility economics." In this way, it represents extreme idealism.

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[1] *Banking Policy and the Price Level*, 1926 (3d ed., 1932); "Saving and Hoarding," *Ec. Jr.*, 1933; "Industrial Fluctuations and the Natural Rate of Interest," *Ec. Jr.*, 1934; "Mr. Keynes and the Rate of Interest," in *Essays in Monetary Theory*, London, 1940, pp. 1–38.

[2] At the outset of this section, the student should note that among the numerous points on which readers of Keynes's *General Theory* sometimes disagree as to Keynes's meaning, are the following: (a) Is Keynes's thought based on the "circular flow" concept? While the relation between income and spending is timeless or instantaneous (thus making difficult the usual idea of a "flow"), it seems

He thought of consumption as often limiting production, not the other way around as the Classical economists did. His well-known "propensity to consume" is treated as a basic independent variable. Consumption, he says, causes demand, and demand brings into existence both production and capital, the latter as a factor of production.[2] Along with investment, consumption is the basis of "effective demand."[3]

This is Hobson's idea. But Keynes put it into monetary terms. He used the term, consumption, as meaning sales to ultimate consumers. Consumption is said to depend upon (1) the level of aggregate money income (and therefore on employment) and (2) the propensity to consume. Throughout, it is *usually safe to assume that to Keynes "consumption" meant spending for consumer goods.*

Thus Keynes generally takes production for granted, and pays slight attention to costs of production. He is prone to treat consumption as equivalent to demand.

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to the author that the *circularity* is clear. Perhaps "circular adjustment" would be a better term. It is in this sense that I use the term, circular flow. (b) Much is made of the "aggregate," and the idea that things which are not true of the individual may be true "in the aggregate." But Keynes himself at points tries to explain his theory in terms of "psychology" and "propensity," and treats collective action as the action of individuals (p. 63). It seems to the author that scientific economics *must* explain or reject principles accordingly as they rest upon individual motives or acts. Otherwise, it relies upon the *ex post* statistical basis. (c) Some seek in Keynes's system a basis for analyzing production and consumption in terms of goods or utility, objecting to any reference to Income, Consumption, Investment, and Saving as mere amounts of money. But Keynes himself appears to make the validity of his system depend upon a balance between aggregate spending (by consumers and entrepreneurs for various purposes) and income in terms of aggregate money revenue. His criterion of homogeneity lies in the "wage unit," which is the amount paid for an hour of ordinary labor. At least, let us recognize the large amount of honest misunderstanding which has attended Keynes's *General Theory*.

[1] The only qualification to this statement that may be made is that Keynes's emphasis of *investment* involves production as a condition that may affect actual consumer spending.

[2] *G.T.*, p. 368.

[3] *Ibid.*, pp. 358, 368–369.

Accordingly, his approach to the problem of the business cycle is that of "underconsumption."[1]

Depression Economics. — This emphasis on consumption is easy to understand in an economist whose thought was conditioned by a severe and prolonged business depression. Some of the ideas were in Keynes's mind before 1930, but the system of analysis of the *General Theory* was formed between 1930 and 1936. This fact explains the emphasis on employment, and on the idea of secular stagnation. Underconsumption cycle theories have always arisen in such times. And then some simple scheme of escape from depression is apt to be sought. Utopia was conceived under such conditions, and the ideal of a planfully managed economy, based on a socialized demand, though concerned with now and here (not with some distant Utopia or Icaria) has appeared to some as a general solution of our problems.

More particularly, it can be said that without assuming depression, and much unemployment and low interest rates, Keynes would have had more difficulty in treating saving as independent of interest rates. Depression made it possible to assume a low demand for money. This alone made it feasible to assume that an increase in spending could cause increased employment *without an offsetting rise in interest rates.* The failure of consumption to rise as interest declines, and the failure of employment to increase as money wages fall — these parts of Keynes's attack on Classical economics are most easily understood as applying in a period of deep depression.

Keynes's thought, therefore, is to be interpreted as being to an important extent the economics of underconsumption in depression.

Disharmony of Interests. — The Classical economics makes some assumption as to harmony or similarity of interests among individuals. Economics which evolves from the Classical thought sees a multiplicity and confusion of conditions and forces, but seeks by competitive analysis to find some equilibrium toward which these tend. But to Keynes, in the midst of a great depression, it seemed that we cannot wait on long-run tendencies. Nor did it seem that any assumption of harmony of interests would serve.

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[1] Cf. above, p. 687.

Adam Smith had assumed one great "propensity to truck and barter" which, under competition, led to division of labor and coöperation. It applied to both consumer goods and producer goods. Keynes, however, emphasized only a "propensity to consume," applying to consumer goods; and while this propensity implies others, they were considered separate and clashing. The environment and "psychological propensities" of the modern world do not produce a stable system.[1] Particularly disturbing is his idea that, at least in a near-mature economy, oversaving inevitably tends to develop in the aggregate. The interests of savers and investors (who are assumed to be different persons) do not match, and this leads to results which clash with the interests of consumers (mostly thought of as laborers). Enterprisers, thought of as private capitalists, are apt to be exploiters or inefficient, or both, and do not require such large rewards as they now get. Keynes usually seems to consider the movement of total income and spending, not as the result of orderly "forces," or laws, but rather as essentially chance occurrences to be analyzed in terms of the theory of probability, and regulated by policy.[2]

Interventionism. — Thus we come to another main characteristic of his thought: Keynes considered central control — control by the state — necessary in order to restore and maintain any generally desirable condition in the economy. In this, as already noted, he resembled the Mercantilists. (Nobody knew that better than Keynes himself.) In short, the Keynesian economics is a matter of "poilcy." (This is implied when he says it is required to make the classical economics work.) Like the Mercantilists, he called upon the state for protection: internally he favored taxation to provide social security for labor without increasing wages; externally he proposed protective tariffs designed to encourage exports.

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[1] E.g., cf. *G.T.*, p. 250.

[2] Cf. Fellner, W., "Employment Theory and Business Cycles," in Ellis (Ed.), *A Survey of Contemporary Economics*, 1948, p. 53 ff.

Specifically, Keynes's theory assumes that tendencies to "save (to not-consume) tend to become greater than tendencies to invest. He assumes that, in our advanced capitalistic economy, investment opportunity and the inducement to invest lag. But saving (not-spending) goes on. Thus a gap arises between income and consumer spending which is too great for investment to fill. This reduces effective demand, which tends to cause reduced output and employment. Finally, income and consumption are affected.[1] The amount of saving ("surplus over consumption") is reduced, restoring the balance between saving and inducement to invest. But this partial and temporary "equilibrium" is one of less than full employment. It is not a desirable or very stable one.

Thus Keynes came to the conclusion that private enterprise alone cannot be relied upon. To the Classical economists (and in good part to such Neo-Classical economists as Marshall and the Austrian School), it seemed that equilibrium is a matter of true balance among opposing forces, to be observed and analyzed by the economist as a scientist. To Keynes and his followers, it seemed that equilibrium is some degree of "moderate" stability[2] to be attained by controls — by "management" guided by "practical intuition" as well as analysis.[3]

"Full Employment" Goal.—But there must be some "end," or criterion of successful management. This Keynes found in "full employment," as a condition in which no involuntary or nonfrictional unemployment exists. Under "full employment," real wages are equal to the marginal disutility of employment to the laborer. One finds suggestions of other more immediate goals, such as a more "equitable distribution of wealth and incomes."[4] But generally, the elimination of involuntary unemployment is presented as the criterion of success in social management.

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[1] *G.T.*, pp. 31, 63, 210.

[2] *G.T.*, p. 250.

[3] *G.T.*, p. 249.

[4] *G.T.*, p. 372.

That this teleological slant arose out of the practical unemployment problem of his time, and had important political implications touching votes and the maintenance of social order, can be surmised.

The General Characteristics of the Keynesian System. — In order to attain such a goal by management policies, Keynes adopted a simplified "macro-economic" theory. He devoted his thought to the conditions which govern output and employment "as a whole" — to aggregates.

Macro-Economics. — His great macro-economic "variables" are Total Consumption, Total Investment, and Total Income for a nation. The formula is that Total Consumption + Total Investment = Total Income ($C + I = Y$).

Admittedly, the procedure involves the danger of overlooking (1) the complexities of the actual processes of economic life, and (2) the effects of the differences among individuals and classes whose individual incomes and expenditures go to make up the aggregates. Wide differences in the dispersion within two equal totals may make them incomparable as bases for policy.[1] But Keynes sought simplicity and action!

"*Monetary Economics.*" — Furthermore, in order to deal with complex aggregates, Keynes adopted what has been called "monetary economics." The Classical economists always clung more or less precariously to "real economics" — real income such as "real wages," and real costs such as labor-pain and abstinence. They tended to treat money as neutral. But the Keynesian aggregates, such as Income, Consumption, and Investment, could hardly be handled in "real" terms. The totals could be struck only in terms of money. Certainly there is confusion between two different processes: the accumulation of real capital as (1) the difference between real production and consumption and (2) a difference between money payments and income.

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[1] E.g., The investment total conceals the important fact of different proportions of fixed and circulating capital, the same difficulty that so bothered Ricardo and Marx.

Moreover, money, money rates, and income taxation appeared to be the great controls, whereby central authority could attain full employment or equalize the distribution of income.

Keynes, therefore, relied upon increasing "effective demand" by increasing the amount and *use* of money — chiefly the latter, by means of investment. Incidentally, this led him generally to assume either that the purchasing power of money remains constant or that the factors of production are not influenced by the "real" incomes received.[1]

Incidentally, this monetary economics is "price economics" and accepts the market price (or a "fixed" price) as a datum. As in the Classical economics, this leads to much circularity of reasoning, as in the opportunity-cost method of explaining depreciation, or the assumption that the number of "units" of labor varies with the price of labor ("wage units").

Income Economics. — It should be emphasized, however, that the Keynesian formulae and policies of the *General Theory* are not *mere* monetary economics, in the sense of an analysis that is based upon the "quantity theory" of money and the regulation of prices by money rates. They represent what may be called *Monetary Income Economics.*

Prior to 1931, the Great Depression, it had seemed plausible to accept the monetary theories of Fisher, Cassel, and others as the basis for control. The quantity of money did not vary too widely as a proportion of the national income, and income velocity was fairly stable. It seemed to many possible that variations in the quantity of money would cause somewhat proportional variations in price.

By 1936, however, it had become widely apparent that an economy could not be managed by merely manipulating either the quantity of currency available or the system of interest rates. It was found that increased quantities of currency had complex repercussions such as reducing the velocity of circulation. And the problem of managing the huge war debt greatly increased the difficulties. Something had to be done to make people *use* the money and the money rates. This requirement called for velocity — for spending, including investing.

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[1] Thus he holds that normally most people do not see through their money incomes to their real incomes, at least if the changes are small.

So "the income approach" was adopted.

To begin with, money income is assumed to exist, without much consideration of the conditions which bring real income into existence, the motivation of producers. Then, great reliance is placed upon bank credit, which is treated as money. Such "money" is different from a gold-based currency, as banks actively desire to lend it, and the first effect is a reduction in interest which encourages borrowing.

Circular-flow Economics. — On this basis, the state is to use various devices (1) to make spending equal income, and thus prevent the evils which follow idle savings, and (2) to make the total income-spending large enough to bring full employment. The procedure that Keynes's thought suggests is somewhat as follows:

1. The Gross National Product (value of output) would be estimated in terms of money, under conditions of full employment, presumably at the beginning of a period.

2. An estimate would then be made of the proportions of the total money payments that would be spent (for consumer goods) and "saved" during the period.

3. Then the investment outlets for such savings would be estimated.

4. Finally, if the estimated savings exceed the investment opportunities (as Keynes's thought suggests would tend to be the case), the state would intervene to create more investment spending. (Presumably if the actual total money income seemed inadequate to give full employment, it would be increased by expanding the credit currency.)

All this assumes a "circular flow" in a closed economic system. Income equals spending; spending equals income.[1]

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[1] *G.T.*, pp. 61–63. "Income = Value of Output = Consumption + Investment." Consumption is "expenditure on consumption," or "value of goods sold to consumers."

More "money" may be added, thus increasing the volume of adjustment; but as long as saving does not exceed investment all income is spent (for consumer goods or capital goods) and the circuit is complete.

Thus the main point is that all money income should be spent as it is received, which requires government controls.

Timeless Economics. — This brings us to the final one of the general characteristics of Keynes's economic system, its *timelessness.* Keynes assumes that the adjustments with which he is concerned take place without time lags — instantaneously.

In his *Treatise,* he had little to say of time, merely assuming that there is enough lag between the market rate of interest and the natural rate to cause variations in profits. In this respect, he was criticized by D. H. Robertson and by Ohlin of the Stockholm School. Over what period of time were the enterpriser's "expectations" of profit to be considered effective? No allowance was made for business cycles.

Keynes might have reacted to this significant criticism either by accepting the "period analysis" developed by Robertson, the Swedish group, and Hicks, or by eliminating time entirely. He chose the latter course. He adopted an analysis which virtually makes no allowance for time or the costs which attend the passage of time. In Keynes's system, Aggregate Income = Aggregate Spending (consumer + investor) *now.* Accordingly, Income — Saving (or Investment) = Consumption currently. This assumes an instantaneous circuit flow or adjustment. *"Expectations" are assumed to be realized.* Thus time differences virtually cancel out.

One may assume that in this problem lay the basis for his interest in the theory of probability.[1] In his *General Theory, some principle of certainty must be assumed.*

Keynes's analysis appears to start with Income. Then Income is assumed to equal Spending, and Saving is merely not-spending on current consumption; that is, not-spending now — at once. In this way, he could assume that the problems of motivating and directing the functions of production are escaped, along with the costs of saving and waiting, or time preference. His system does not concern itself with these things; hence the assumption that saving equals, or should equal, investment. Interest would thus hardly be necessary to induce the formation and use of capital in production. Hence, too, Keynes's lack of attention to other than insurable risks, and to uncertainties in production.

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[1] Keynes wrote *A Treatise on Probability,* 1921.

The whole point appears clearly in the shift from the equation-of-exchange, monetary economics of the *Treatise*, to the Income = Spending economics of the *General Theory*. In the former V (velocity) is an element, and that is significant only in time. Velocity is measured per unit of time. But Income = Spending *now* can be formally expressed in timeless terms. Then instead of V, Keynes accepts the Marshallian k, or holding idle, which is liquidity preference (as opposed to time preference), and Income times (1 − k) becomes the timeless equivalent for spending.

Thus Keynes's timeless economic system requires the assumption of conditions which come to much the same sort of abstraction as the Classicists' assumption of perfect competition. And in a sense, it is static.

Details of Keynes's Scheme; Propensities and Controls. — Keynes's scheme of economic analysis centers on the goal of full employment. Being a monetary economist, however, the goal is sought through the full employment of *funds*. Thus it becomes a scheme for attaining a full or uninterrupted circular flow of funds — full spending. Then Income = Spending = the sum of the prices paid or "value of output."

This may be thought of as an attempt to put Say's Law[1] into monetary terms, and Keynes refers to this.[2] But just as there are limitations to the application of Say's Law, Keynes finds that there are limitations to the circular flow of funds. These affect spending. Spending he considers to be all divided into two great branches: (1) spending for consumer goods, which he calls "Consumption," and (2) spending for producer goods, or capital, which he calls "Investment" (Income − Consumption = Investment). But consumption spending, he says, is a relatively stable function of income — as a propensity it is a "constant" — and does not increase in the same proportion as income. Therefore, the other element in spending, or "investment," becomes the critical one. This is the item in which disturbances or interruptions of the circular flow of funds arise. These *disturbances result from not-spending for investment, which causes idle funds.* Assuming full employment to be the main test of a successfully managed economy, Keynes's thought is that success can be attained only by means of (1) an aggregate investment in capital goods large enough to support a proportion of the population employed in producing such capital goods that is sufficient to make, (2) the aggregate effective demand equal to the aggregate supply of all *finished* goods (including both consumer goods and capital goods). This idea is taken to mean that savings, or all of that part of income which does not pass into consumption spending, must be invested in capital goods.

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[1] See above, pp. 356–357.

[2] *G.T.*, p. 26.

The problem, to Keynes's mind, thus becomes this: Why does under-investment-spending develop? Or, to put the same thing another way, why do we have overholding of such funds as are not spent for consumption?

By adopting certain definitions, and assuming certain forces which he calls "propensities," "inducements," or "preferences," Keynes undertakes to provide a workable scheme whereby all savings available for investment may be spent, thus making full spending and greatly contributing to full employment. He says employment equals hours of ordinary labor weighted by wage units (*G.T.*, p. 39). Thus employment and income are equated by definition. Output is assumed to be a function of employment. Thus output, income and employment are all determined together by effective demand, that is, spending. This is by definition. On this basis, the theory is consistent. But is it real?

The Determinants.—To begin with, one should note the "forces" which he regards as the "determinants" of the system:[1]

1. First, and of primary importance, comes what Keynes calls the "*propensity to consume.*" This he treated as a basic "constant," calling it a "psychological principle." In actual practice, however, it appears as the proportion of any given total annual income[2] of a nation that tends to be spent for consumer goods. This is a statistical aggregate, and is treated as a percentage of the total national money income. It is presented as a function of income, in that, as income grows, it tends to be a smaller percentage of the total.

2. Second, comes Keynes's "*inducement to invest,*" or "anticipation," "investment opportunity," etc. This might be called, for purposes of uniformity, a propensity to invest; since it involves a tendency to spend money for capital "assets," as distinguished from consumer goods. Thus it also means *not-saving* any funds available for investment — not holding any funds uninvested or idle.

Whether thought of as a propensity-to-invest force or as the actual rate of investment, it is not a function of income. It is said to depend upon two main conditions:[3] (a) the anticipated yield of invested capital over its life, and (b) current money rates, or the "cost" of the investment. (These money rates, in turn, depend upon two main conditions, (a) the quantity of money and (b) the desire to hold cash, which Keynes calls "liquidity preference.")

The anticipated net yield, or "marginal efficiency of capital," as Keynes usually calls it, is a complex thing which he says depends upon the following conditions: (a) current stock of capital assets, (b) current consumer demands, and (c) future demands, bids, and labor costs.[4]

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[1] *G.T.*, pp. 183–184.

[2] But income itself may be affected by investment opportunity and employment.

[3] See *G.T.*, pp. 147–149.

[4] *G.T.*, pp. 147–149.

3. Third, among Keynes's main forces, comes the idea already mentioned, "*Liquidity Preference.*" This refers to an assumed tendency to hold cash idle. It may be thought of as a propensity to "save" in the sense of not-spending (either for past consumption or for future investment). Keynes himself refers to it as a "propensity to hoard."[1] Or it may be thought of as one's preference for cash, as against investments. It plays a very important part in the scheme.

Unfortunately, liquidity preference is not a clear-cut concept. It is the negative of a complex positive, "spending." Thus it may include not-spending for consumption, which is the ordinary or popular sense of the word "saving"; and it may also include not-spending for investment, which has a very different significance. But if one thinks of it as the practical equivalent of merely holding money idle (almost like "hoarding") the general idea is clear enough. Keynes's "*liquidity preference*" *means not-spending* (for consumption) + *not-using savings* (for investment).

This double meaning appears in the reasons given for liquidity preference, which are said to include a transactions motive, a precautionary motive, and a speculative motive. These are quite different in their economic significance, as the first two are concerned (directly) with consumption, while the "speculative motive" is related more closely to what Keynes thinks of as investment.[2]

Thus it is clear that liquidity preference as a "propensity" must affect the other two propensities. It enters into a person's "propensity" to spend for consumer goods, by making him tend to "hold on to" more of his cash than he otherwise would do. It enters into his "propensity" to invest, by affecting his demand for money and so the current interest rate on funds, which is one great factor in determining the inducement to invest.

The Multiplier. — This is the point at which to inject Keynes's adoption of the much-debated "multiplier," a factor derived from the "propensity to consume" and emphasizing the part played by "investment."[1] With a given propensity to consume, the ratio of income to investment is the multiplier. The idea is that variations in employment and income depend chiefly upon investment. Increased investment increases employment in capital-goods industries, which tends to stimulate industries producing for consumption, thus leading to an increase in total employment up to the point of full employment. Beyond this point it would merely inflate prices. If, then, there be (1) underemployment, and (2) a given income and a given spending for consumption, any increase in "investment" spending may have a multiplied effect. Thus, subject to possible adverse reactions ("leakages") and modifications of consumption, Keynes argues that a government, by stimulating investment spending, *may* produce a more-than-proportionate or a "multiplied" increase in employment — perhaps a fourfold increase.

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[1] *G.T.*, p. 174.

[2] *Ibid.*, p. 171.

The Over Simplification of Spending. — One observes that the foregoing thought is all in terms of spending — to spend, or not to spend, that is the question. It is hardly possible to find the *source* of the "income" which is to be spent. The two "forces" mentioned first are "propensities" or inducements to spend, in consumption and investment. The third is a negative tendency to not-spend. Though mere "liquidity preference" must doubtless be preceded by saving or thrift (perhaps as a mere habit) if it is to keep the spending from excess, Keynes does not set up such a force as, say, a propensity to be thrifty.

The "system" he presents is thus extraordinarily simplified. The classes of consumption spending such as necessary, luxurious, and wasteful are not brought in, to say nothing of durables and non-durables. "Investment" appears to cover all spending other than consumption,[2] thus possibly embracing such diverse elements as speculation, gambling, and war.

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[1] *G.T.*, Chap. X, especially pp. 118–119. Keynes attributes the idea of the multiplier to R. F. Kahn, "The Relation of Home Investment to Unemployment," *Ec. Jr.*, June, 1931. The idea, however, does not seem to be novel — merely its use as a cog in Keynes's machine. See Anderson, C. J., "The Development of Pump-priming Theory," *Jr. Pol. Econ.*, 1944.

[2] Investment = Income − Consumption.

To be specially noted in the history of economic thought is the failure to attach any considerable theoretical importance to the difference between fixed capital and circulating capital. This omission attends a timeless economics. It evades the difficulty which besets the thought of Ricardo and Marx.

It is to be added that Keynes's "propensities" are interrelated and overlapping, which tends toward confusion. Thus any liquidity preference must affect both consumption and investment, the former through its effect on velocity of spending and employment, the latter through its effect on current interest rates. This makes difficult the application of formulae based on these propensities regarded as forces that may be treated as independent variables.

"Secular Stagnation," and Controls. — Such being the "forces," toward what result do they tend? Keynes, as he tells us in his Preface, is concerned with their effect on the totals of output and employment — two phenomena which he regards as practically the same thing. As already noted, Keynes held that they tend to no stable or desirable equilibrium, none associated with full employment. This is true for several reasons: Saving and investment tend to diverge, because they are performed in part by different people, and because of different motives. Inequality in income also affects both consumption and saving. And, *in the long run, there is assumed a tendency of investment opportunity to decline; since saving persists, so that the "marginal efficiency of capital" may even fall below the current money rate.* This long-run tendency leads to Keynes's famous doctrine of *"secular stagnation."*

Accordingly, government intervention is called for. The general idea is that the state must step in to create purchasing power and thus "socialize demand." In this way, investment spending may be increased as required to prevent oversaving from breaking the circular adjustment.

Keynes proposed three main economic controls: (1) *Control over money supply, chiefly bank credit.* This would give important control, he thought, over income, and therefore over saving.

(2) *Control over the interest rate.*[1] This, he thought, gives much control over investment, and therefore unemployment. (3) *Taxation.* This might be used for several purposes, but mainly to equalize the wealth and incomes of individuals, thus affecting saving.[2] To these may be added (4) "a somewhat comprehensive socialization of investment" to allocate the use of resources.[3]

Thus Keynes's thought, after presenting certain causes of incomplete equilibrium and unemployment, leads to the suggestion or proposal of a scheme of government control over the economic life of a nation, which he himself likens to Mercantilism, and which some of his followers have even likened to Marxian Socialism — certainly to some sort of Nationalism.

Keynes's Thought on Value and Distribution. — In concluding this brief account of Keynes's economic system, a History of Economic Thought should consider what, in Keynes's mind, becomes of the theory of Value and Distribution — of microeconomic analysis?

To begin with, Keynes's system rests upon no individual human motivation as the basic economic quantity: he accepts neither utility as a desire intensity nor disutility as a "real" cost. *To Keynes, the economic quantity is the "wage unit,"* as he calls it.[4] This has two aspects: (a) price, and (b) employment. In other words, the so-called "wage-unit" is the "ordinary" price paid for one hour of "ordinary labor," or the "ordinary" money-wage rate per hour. Therefore, it may truly be said that Keynes's system stands upon two legs: money (credit) and man-hours.[5]

Accordingly, he attempted no theory of value, and "value" does not appear in the index of *General Theory*. He presented no theory of Distribution in the ordinary theoretical sense of the term. He formulated no theory of wages. Opinions may differ as to whether his references to Marshallian theory indicate that he would have accepted it. Could he have done so while maintaining his own system?[1] In 1946 he wrote: "I do not suppose that the Classical medicine will work by itself or that we can depend on it. We need quicker and less painful aids . . . ."[2]

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[1] Keynes was not clear as to just what concrete rate or rates, and his followers have had much difficulty here. They talk of a "system" of interest rates.

[2] *G.T.*, pp. 372–373.

[3] *Ibid.*, p. 378.

[4] *Ibid.*, p. 41.

[5] It is interesting to reflect that in a timeless economics we thus find time of the essence! Money means credit, which is a "time payment," and labor means time worked.

His thought was concerned with the general level of prices, considered as money payments for goods of all kinds. And he treated prices as "depending on" the (1) marginal payments for the factors of production and (2) the volume of output.[3] But when considered as a total or average for all goods, he said that the price level may be affected by changes in "demand"— as if there were one demand for all goods! He spoke of a *general* supply and demand.[4]

Of course, this notion of a "total value" or a general price level is dangerous. We have seen something of the same thing in Marx's last stand on the ground of total value and "socially necessary labor time."[1] Keynes had to make sweeping assumptions concerning constant "equipment and technique" and a constant relation between his "ordinary" wages (his so-called "wage-unit") and any other factor payments. On such sweeping assumption, he suggested that the general price level is the relation between all money and the labor-time in all goods.

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[1] On pp. 378–379 one finds the statement that *if* we suppose total output (and income) determined by forces "*outside the classical scheme*," Keynes sees no objection to the Classical analysis of the determination of what particular goods, proportions of factors, and distribution of products, *excepting the* "*problem of thrift*." With the "if" and the exception, it is not clear how much of the Classical system would be left. In a later writing Keynes warned against forgetting the good in the Classical theory, but added that it is associated with doctrines "which we cannot now accept without much qualification." (Present writer's italics.)

[2] "The Balance of Payments of the U.S.," *Ec. Jr.*, 1946, p. 186.

[3] *G.T.*, p. 294.

[4] In his *Treatise*, Keynes says, he had kept the subject of money "separate from the general theory of supply and demand"; but that he made progress toward "pushing monetary theory back to becoming a theory of output as a whole." The *General Theory* thus became a study of "the forces which determine changes in scale of output and employment as a whole." I am keenly aware of Keynes's problem with respect to money as a part of a system of value and distribution. But I have taken an almost opposite course in dealing with it. In my *Value and Distribution* (Chap. VIII) I treat money as an indirect good which has its objective value determined at the time a direct good is exchanged for it. Instead of seeking homogeneity in "wage units" or "labor units," I find it in units of positive desire-tendency (utility) and of negative desire-tendency (cost), resulting in individual *subjective* worths and values, out of which objective exchange values arise as social phenomena. And I deny the validity or reality of a *general* value of money or of any other goods.

Back of all these concepts of *general* demand and supply and aggregate quantities, lies a simplification of the conditions of production and consumption, notably the former. Differences which many other economists have thought important were not accepted by Keynes. Thus he appears to think of the agents or factors of production as virtually reduced to labor and "property." (Credit money may be thought of as claims, or property rights.) He said that he would "take the unit of labor as the sole physical unit which we require in our economic system" apart from units of money and time,[2] and he constantly refers to his so-called "wage-unit" as a base.

Accordingly, *Keynes usually called capital, "assets," indicating that it is business property, not a technological or functional producers' good.* He stated that it is preferable to say that capital has a yield above cost rather than that it is "productive,"[3] and expressed "sympathy" with what he called the "pre-Classical doctrine" that everything is produced by labor, aided by the "results of past labor, embodied in assets," which we must conclude is his concept of capital.

In keeping with this concept of labor, is the treatment of capital and enterprise, and their "shares," interest and profits. Capital is an "asset" in terms of money. It gets its value from expected future services,[4] and the only reason we have to pay interest above a minimum liquidity-preference rate lies in an unnecessary scarcity value which enables "the capitalist to exploit" others by exerting a "cumulative oppressive power."[5]

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[1] See above, pp. 489–490, 494.

[2] *G.T.*, p. 214.

[3] *Ibid.*, p. 213.

[4] Money is a link between present and future, according to Keynes.

[5] *G.T.*, p. 376.

No intrinsic reasons exist for the scarcity of capital.

Enterprise is "the activity of forecasting the yield of assets over their whole life."[1] But whether it is associated with labor or investment is no clearer than in Marshall's thought.[2] Thus Keynes said it may be included in labor "as the sole factor of production";[3] but he usually treated the entrepreneur as an investor, and his "profits" as a part of interest: The net profits of enterprise appear to be the gross profits of business minus interest paid.[4]

Interest tends to be something a little above zero because of "Liquidity Preference." Net profit tends to be zero. Pure profit in excess of wages of management is hardly necessary, though perhaps a risk-determined minimum exists.

Remembering his assumption of a tendency to secular stagnation, one may infer that Keynes in his *General Theory* considered as desirable the disappearance of (1) those who live on the interest from their savings, of (2) the scarcity value of capital and payment made therefor, and of (3) any motivation of private enterprise by "profits" that are in excess of wages of management, including an allowance for risk.[5] In part, these ideas came from his pessimism concerning long-run limits to the use of capital toward which he thought we are moving.

The Critics of Keynes's General Theory. — Following the appearance of the *General Theory* in 1936, came a long list of critics of Keynes's doctrines. Some hastened to attack, and later fell in step with the Keynesians. The following summary contains the criticisms of those who, having generally recognized standing as economists, have on the whole remained steadfast in the opposition or criticism. Doubtless many others could be found who have not expressed themselves in the economic journals, or in some other way that might attract attention.

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[1] *G.T.*, p. 158.

[2] See above, p. 648.

[3] *G.T.*, pp. 213–214.

[4] The picture I get from the *General Theory* is one of (1) labor opposed to (2) property owners of land and capital "assets," with two main classes of owners: (a) Entrepreneur Investors and (b) Functionless Investors (Rentiers). The entrepreneur investor performs the labor of forecasting the yield on this property, including funds borrowed from the mere Rentier.

[5] Cf. *G.T.*, pp. 375–376.

Some critics may be classed as being thoroughly and fundamentally opposed.[1] Others appear as partially critical,[2] or as accepting portions of Keynes's doctrine while criticizing it in some basically important respect.[3] Still others may be classed as sympathizers who attack some important part of the doctrine in an important way.[4]

Concise Summary of the Attack. — An attempt to epitomize and sum up the adverse opinions may give the following results:

Keynes's various "propensities" and particular points (e.g., the multiplier) are all old. (Some commentators have criticized him for unfairness to predecessors.[5])

Extreme idealism.

The use of many assumptions, and too much reliance upon arbitrary definitions, or tautology.[6]

Oversimplification.[7]

Failure to allow for time periods.[8]

Overworks "expectation" as an independent variable,[9] and fails to integrate it with the general theory.

The theory is not general, but applicable at best to particular economies under particular conditions.[10]

Essentially static.[11]

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[1] T. Greidanus, G. von Haberler, L. A. Hahn, L. H. Haney, C. O. Hardy, F. A. Hayek, F. H. Knight, E. Mantoux, A. W. Marget, O. von Mering, H. G. Moulton, A. C. Pigou, J. Rueff.

[2] J. M. Clark, S. H. Slichter, D. McC. Wright.

[3] G. Cassel, W. Fellner, C. B. Hoover, E. Lindahl, B. Ohlin, J. A. Schumpeter.

[4] G. Bernacer, D. G. Champernowne, R. F. Harrod, R. G. Hawtrey, J. R. Hicks, G. Kramer, W. Lautenbach, W. Leontief, D. H. Robertson, A. Smithies, J. Viner.

[5] Hahn, Knight, Mantoux, Pigou.

[6] Knight, F. H., "Unemployment and Mr. Keynes' Revolution in Economic Theory," *Canadian Jr. of Econ. & Pol. Sci.*, 1937.

[7] Schumpeter, *Jr. of the Amer. Statistical Ass'n.*, 1936.

[8] Haberler, *Prosperity and Depression*, 1941, p. 312n.

[9] Clark, J. M., "Some Current Cleavages among Economists," *Papers & Proceedings of the Amer. Econ. Ass'n.*, 1947.

[10] Rueff, Knight, Hoover. See Rueff, J., "The Fallacies of Lord Keynes' General Theory," *Quart. Jr. Econ.*, May, 1947; Hoover, C. B., "Keynes and the Economic System," *Jr. Pol. Econ.*, 1948.

[11] Harrod and others.

Keynes's "social vision" colors his theory by determining his assumptions and applications.

The idea that the limitations on the *application* of "classical theory" (caused by institutional rigidities) destroy the validity of such theory.[1]

No real equilibrium exists in a condition of underemployment.[2]

Assumes income; is underconsumption theory.

Overemphasizes "full employment" as against production and income.[3]

Is monetary economics, accepting "bank money" as a datum, and assuming that the demand for money equals that for goods.

The "variables" relied upon are interdependent, preventing non-circular reasoning and general conclusions.[4]

Inevitable "repercussions" of the controls proposed would and do vitiate conclusions and defeat policies.[5]

Fails to allow for true economic motives such as those affecting the individual's attitude toward saving and investing.[6]

Tendency to slur over obstacles to supply.[7]

The "propensity to consume" is not developed accurately or consistently; particularly there is confusion between the *ex post* and *ex ante* positions.[8]

The multiplier is a "myth," based largely upon mere assumptions; it is not new.

Too sweeping a denial of a relation between wages and employment.

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[1] Fitch, L. C., "Comments on Keynesian Economics," *Pol. Sci. Quarterly*, 1947.

[2] Haberler (also Leontief among more radical economists).

[3] Mantoux, E., "La Théorie Générale de M. Keynes," *Rev. d'Écon. Pol.*, 1937; Haney, L. H., "The Theories of the New Deal Economists," *Com'l. and Fin'l. Chron.*, Oct. 7, 1943.

[4] Ohlin, B., "Some Notes on the Stockholm Theory of Savings and Investment," *Ec. Jr.*, 1937. Reprinted in *Readings in Business Cycle Theory*, 1944. Cassel, G., in *Int. Labor Review*, Oct. 1937.

[5] Hahn, L. A., "Compensatory Reactions to Compensatory Spending," *Amer. Econ. Rev.*, 1945; also *Deficit Spending and Private Enterprise*, Post-war Readjustments Bul. No. 8, U.S. Chamber of Commerce, 1944.

[6] Greidanus, T., *The Development of Keynes' Economic Theories*, 1939.

[7] Wright, D. McC., "The Future of Keynesian Economics," *Amer. Econ. Rev.*, 1945.

[8] Haberler, G., "Mr. Keynes' Theory of the 'Multiplier': A Methodological Criticism," 1936 (reprinted in *Readings in Business Cycle Theory*).

Low interest rates cannot be counted on as a stimulant.

The theory of "investment opportunity" is inadequate; it does not explain an over-all deficiency in inducement to invest.[1]

The attempt to equate saving and investment fails.

No place is given to speculation as distinguished from investment.

"Liquidity preference" is inadequate as a theory of interest; no adequate interest theory.

Progressive taxation may lead to increased enterprise risks and decreased employment.

In several cases, Keynes's proposals for controls or remedies are inferior to others which are available.[2]

Keynes's theory leads to Socialism. It resembles Marx's thought in some respects.

Among the more sympathetic critics, the most common points appear to concern Keynes's treatment of time, the static character of his theory, his definitions (such as defining saving and investment so as to make them equal), his underemployment equilibria, and his generalizing on the basis of temporary or local conditions.[3]

The Followers of Keynes, Particularly in the United States. — As a result of these criticisms, "Keynesian economics" has tended to break down into a group of diverging doctrines which have in common "the national income approach," some degree of "functional finance," and some tendency toward a "managed economy." The proponents of the various diverging tendencies emphasize their several amendments or corrections of Keynes's *General Theory*, and they criticize each other's versions of the Keynesian doctrines.[1]

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[1] Fellner, Wm., "Employment Theory and Business Cycles," in *A Survey of Contemporary Economics* (Ellis ed.), 1948, pp. 67–68.

[2] von Mering, O., "Some Problems of Methodology in Modern Economic Theory," *Amer. Econ. Rev.*, March 1944.

[3] Professor D. McC. Wright notes the admissions by a follower of Keynes that (1) Keynes's underemployment *equilibrium* depends upon wage rigidity, that (2) the loanable-funds theory of interest can be reconciled with Keynes's "liquidity preference," and that (3) investment is not always determined by income. He concludes that these admissions "negative once and for all many sweeping Keynesian claims concerning the scope and generality of the *General Theory*." (Review of Klein's *The Keynesian Revolution* in *Amer. Econ. Rev.*, March 1948).

Neither the spread of Keynesian thought nor the divergence among the varieties of it has been entirely the result of Keynes's own theories. There was much Keynes-like thinking in the world, particularly in America, before the *General Theory;* and the New Deal developed at first without it. But it may be said that, after 1937, whether by mere adoption or as a causal condition, "Keynesian" doctrines were a widespread if not a predominant element in government and academic circles — particularly so among the younger economists.

As time went by, however, there was less reading of the *General Theory* and more writing about it. This took two forms. First, exegesis: books expounding the master's thought were published.[2] Second, by 1948, following some infiltration into certain established texts through revision,[3] the Keynesian doctrines had begun to appear in various degrees in textbook form.[4]

The difficulty of classifying the so-called "Keynesians" is obvious. Their thought ranges all the way from a defense of capitalism to an advocacy of the doctrines of Marx. This difficulty is, in large part, a result of the conflicting utterances by Keynes himself, and the qualifying assumptions which he imposed on his theory. Keynes relied much on intuition. He was deeply interested in propaganda or "persuasion." These things resulted in inconsistent elements. And on top of this, comes the fact that Keynes based his *General Theory* on *certain assumptions which some of his followers either have found irk-*

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[1] Cf. *A Survey of Contemporary Economics* (Ellis ed.,) 1948, and the review of it by Haney, L. H., in *The Annals of the Amer. Acad. of Pol. & Soc. Sci.*, March 1949. One observes some tendency of each to claim to be the true representative of Keynes.

[2] E.g., by A. H. Hansen, S. Harris, A. P. Lerner, L. Klein, P. A. Samuelson, D. Dillard, and M. F. Timlin.

[3] E.g., Bye, R. T., *Principles of Economics* (1941 ed.); Meyers, A. L., *Modern Economics, Principles and Problems*, 2d ed. 1948.

[4] E.g., elementary college texts by L. Tarshis (1947), P. A. Samuelson (1948), T. Morgan (1948), G. Soule (1948), D. Dillard (1948), and others.

some or have not observed: He assumed both given technological conditions and given tastes, which assumptions, if accepted, contribute greatly to the possibility of accepting his secular-stagnation theory in the abstract.

Thus in any attempt to classify Keynesians one must distinguish not only between what Keynes himself said and what he meant, but also between what he meant and what they think he meant. Particularly difficult is it in English-speaking countries to allow for differences in meaning attached to such terms as "free private enterprise" and "conservatism." Some profess to advocate the former, but under conditions of central control, highly progressive taxation, or deficit financing for public works, which others think to be inconsistent with such enterprise, and therefore "radical." To argue that deficit financing is undesirable *only* when a full-employment equilibrium exists may amount to favoring it (and attendant limitations on private enterprise) most of the time. And what constitutes "employment"? When is it "full"? With due allowance for the difficulty in getting agreement as to what Keynes *meant*, and what conservatism is, one may say that by 1948 the term "Keynesian" had come to include:

(1) Some who accepted Keynes's general approach to the economic problem and his main "controls." These might be divided into (a) economists who consider themselves (and Keynes) essentially conservative, as A. H. Hansen,[1] R. F. Harrod, R. F. Kahn, N. Kaldor, and P. A. Samuelson,[2] and (b) those who think Keynes's thought more radical, and who, seeing little hope in the free private enterprise system, lean toward a high degree of central control. Here would come A. P. Lerner,[3] L. R. Klein,[4] Joan Robinson,[5] and L. Tarshis,[6] though in dif-

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[1] *Economic Policy and Full Employment*, 1947; *Fiscal Policy and Business Cycles*, 1941.

[2] *Economics*, 1948.

[3] *The Economics of Control*, 1944.

[4] *The Keynesian Revolution*, 1947.

[5] *An Essay on Marxian Economics*, 1947.

[6] *The Elements of Economics*, 1947.

ferent degrees. Somewhere in between would come W. Beveridge,[1] S. E. Harris,[2] M. Polanyi,[3] and D. Dillard.[4]

(2) But some may be called Keynesians only to the extent that they accept Keynes's theory in a narrow sense, or merely make use of some part of it for their own purposes. Thus (a) on the one hand, D. McC. Wright[5] and A. Smithies[6] accept considerable portions of Keynes's theory *subject to the qualifications* which Keynes made, which qualifications greatly limit its application to the world of reality. On the other hand, (b) such radical collectivist thinkers as O. Lange[7] and P. M. Sweezey,[8] while going to Marxian extremes, find parts of Keynes's doctrines useful.[9] These find in the doctrines of Keynes support for their own schemes which look toward a collectivist society.

And in addition to the foregoing, a good many economists make some use of Keynes's categories or models for their econometrics, as do J. Tinbergen[10] and J. R. Hicks.[11]

Plainly the term "Keynesian" has become too broad to be used precisely. It may cover such great differences in thought as lie between Wright and Klein, or between Harrod and Robinson.

Of course, one who merely makes use of one of the cogwheels in Keynes's machine thereby hardly becomes a follower. The foregoing classification is not intended to include a considerable number of economists who may have found some one of the "propensities," classifications or bits of analysis contained in Keynes's *General Theory* of use as a part of an "orthodox" theory of value and distribution. It seems that one who accepts the idea that the system of private enterprise and private ownership of capital goods can work automatically, and that it is important to develop a theory of economics based on that assumption, is thereby required to allow adequate motivation for private savers, investors, and enterprisers. Thus he can hardly be a follower of Keynes *except in a narrow or qualified sense.*

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[1] *Full Employment in a Free Society*, 1945.

[2] *The New Economics*, 1947.

[3] *Full Employment and Free Trade*, 1945. While accepting voluntary private enterprise, Polanyi advocates a full system of deficit financing to create full employment; approves of Lerner's thought.

[4] *The Economics of John Maynard Keynes*, 1948.

[5] "The Future of Keynesian Economics," *Amer. Econ. Rev.*, 1945; *The Economics of Disturbance*, 1947.

[6] "Forecasting Postwar Demand," *Econometrica*, 1945; "Federal Budgeting and Fiscal Policy," in *A Survey of Contemporary Economics*, Ellis (ed.), 1948.

[7] "The Rate of Interest and the Optimum Propensity to Consume," *Economica*, 1938.

[8] *The Theory of Capitalist Development*, 1942.

[9] Some might argue that L. R. Klein would come here.

[10] *Business Cycles in the United States of America*, League of Nations, Geneva, 1939.

[11] "Mr. Keynes' Theory of Employment," *Ec. Jr.*, 1936; *Value and Capital*, 1939. Hicks, however, criticizes Keynes at important points.

Reasons for Keynes's Great Influence. — The great influence of Keynes's doctrines requires explanation. It is not unparalleled in its scope, or in its intensity: the Austrian School in the period 1900–1914, and the English Classicism, 1815–1848, would perhaps exceed it in general acceptance. Physiocracy (locally) and Marxian Socialism may exceed it in intensity of effect. But such comparisons emphasize the extraordinary effect of Keynes, which is the reason for giving so much attention to his doctrines in a general history of economic thought.

Somewhat in the order of their importance, the main factors in the spread of Keynesianism were as follows:

1. First, comes the fact of the Great Depression of the thirties. Born of industrial stagnation and unemployment, Keynes's system promised a way to recovery — for example, his *Means to Prosperity*, 1933. The influence of the depression is to be seen in the prominence given to secular stagnation, the mature economy, and technological unemployment.

And the unusual length of the Great Depression of 1931–1933, together with the extraordinary breadth and exhilaration of the great boom which preceded it, made its effect the deeper. It seemed, especially to the younger generation, that something must have been fundamentally wrong with "the economy" and with the economics which were supposed to fit it.

2. Closely related were World War I and its aftermath. Although the war was partly responsible for the depression,

many were impressed by the power of social controls set up in wartime. There was a widespread feeling that "we can win the peace," much as the war was won, a notion which Keynes himself entertained and spread. The conclusion was drawn that no lack of funds should be allowed to limit the want satisfactions or the "process of industrial growth" of a nation.

The war, too, begot nationalistic thought. It attended a growth of organization and policies designed to protect and stimulate national economies, somewhat as in the Mercantilist period. This parallelism Keynes was quick to grasp.

3. The war, followed by depression problems, begot and maintained bureaucracy and "political arithmetic." Politicians and economists had a taste of power and prestige, and some tended to cling to these.

4. Very important, in this connection, was the condition of the United States at this time. Keynes's *General Theory* might not have had much more influence than the theories of Hobson or Veblen, had it not been so well adapted to appeal to those in control of policies there. Indeed, a forecast of the influence that Keynes's doctrines would gain may be seen in the attention previously attracted by Foster and Catchings' *Road to Plenty* with its scheme for remedying depressions by stimulating consumer buying through monetary inflation. The idea of *spending* (whether public or private) to make business good was rampant in the United States of the thirties. The importance of this appeal was clearly apparent to Keynes.

The United States in 1936 was in the midst of the New Deal experiment, which embraced several policies akin to Keynes's. His doctrines caught that nation "on the rebound," and gained ready acceptance. Large government spending was sanctioned by Keynes's theory. From 1933 on, he wrote with one eye on the United States. In 1938, after a period of suspicion,[1] President F. D. Roosevelt frankly adopted Keynes's general policy for dealing with depression, deficit financing ("functional finance") and all. In the Bretton Woods agreement of 1944, Keynes was influential.[1]

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[1] Keynes advocated the international conference which occurred in London, 1933, and which was negatived by Roosevelt's action. After his first visit with Keynes in 1934, the President "was not pleased with Keynes's 'rigamarole' of figures. Keynes, on his part, expressed surprise that the President was not more literate in economic matters." Harris, S. E., *The New Economics*, 1947, p. 17.

5. General changes in social and economic conditions are to be noted. Few would deny that by 1936 it could be said that in both England and America there was more complaint about imperfect competition and insecurity of employment, and much more of central credit control and of statistical information, than had been the case in the generation prior to World War I. By 1929, of course with some exceptions, one may say that people had lost much faith in democracy *as then organized*, and that thinking leaders (e.g., Pareto) had lost much faith in the people. Accordingly, many economists questioned the possibility of harmony through free individual choice. All saw more clearly the difficulty of attaining or assuming perfect competition. The general trend was toward more central control over economic life.

Hence: Communism in Russia, Fascism in Germany and Italy, the New Deal in America, and Keynes and Labor Party Socialism in Britain. The American and British phases, though different, had something in common.

6. The condition of economic theory facilitated — perhaps invited — the Keynesian "Revolution." In general, the pre-Keynesian economics did not proceed from any law of economic motivation based on the observed motor tendencies of the free individual. Thus it either *mixed* ethics and politics with its doctrines, or failed to consider them at all — both extremes. It had no concept of competition as a *positive* condition. Demand and supply were treated as quantities of goods bought or sold at assumed prices, resulting in total sales or expenditures; so that there was no real explanation of margins or automatic equilibrium levels.

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[1] A distinct point (4a) might be made of the financial strength and the power of the United States; since to attain influence in the affairs of that nation probably assured more influence in other nations than could otherwise have been exerted.

Marshall's weak spots further weakened the resistance of the existing theory — notably his lack of a theory of enterprise and profits, and of a theory of the value of money. His acceptance of the idea that money has a marginal utility, so that there is an opportunity cost of spending or preference for liquidity, was vulnerable. The idea of the "national dividend" as a net sum after replacement charges for the factors of production subtly suggested the possibility of zero interest and profits.

This suggests the "social heritage" concept, and reminds one that to the foregoing should be added the existence of Institutionalism, which did a great deal to prepare the way for Keynesianism in the United States.[1] Certainly the younger and more positive Institutionalists[2] readily adopted much of Keynes's scheme of action. The tendency of Veblen and his followers has been to consider saving as a rather undesirable bourgeois habit, and to seek to cure depressions by institutional changes.

In the light of the foregoing factors, it is easy to understand how much departure from Classical thought would exist, and how a scheme of action such as Keynes presented would have wide appeal. Keynes's *General Theory* has proved to be an effective basis of propaganda for sweeping changes in the private-enterprise system. While the book itself is not popular or easy reading, it presents an apparently simple "system," governed by a few definitely named forces, which can be quickly learned. It does not go into the complexities of causation — into the psychological and technological conditions of human motivation — but sets up a scheme of social controls which may be used as a "model" by almost any kind of reformer.

Keynes himself may not have wished to see "capitalism" destroyed. But among Keynes's doctrines, the following have been particularly effective for use by more or less radical thinkers:

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[1] Cf. Gambs, J. S., *Beyond Supply and Demand*, 1946; Vining, R., "Suggestions of Keynes in the Writings of Veblen," *Jr. Pol. Econ.*, 1939; Ayres, C. E. "The Impact of the Great Depression on Economic Thinking," (*Papers and Proceedings*), *Amer. Econ. Rev.*, 1946. There is probably some truth in Gambs's suggestion that Keynes may be thought of as outbidding Veblen for the following of young men who desired to replace a "decadent" capitalism as quickly and cheaply as possible.

[2] See above, p. 721 f.

Underconsumption is partly caused by unequal distribution of income.

The "national income approach": that social aggregates may be treated without much consideration of differences among the parts or reactions therein.

Money is credit, and requires no standard material.

The goal of policy is "full employment," without much regard to value of products.

Saving does not govern investment, and does not necessarily limit it.

Interest is not necessary to motivate saving.

Private enterprise and competition cannot be relied upon for full employment.

The long-run tendency to "stagnation."

Keynes held that men are different, that men's interests are in conflict; and that under the private enterprise system, decisions concerning saving and investment are divided.[1] If, as some authorities hold, Keynes wanted to save private enterprise and make it work, he also wanted it to work subject to the conditions as to thrift which he imposed, and these involved a change in economic forms, a narrowed scope for individual initiative, and a large extension of government function.

At the same time, the fact that Keynes was a Cambridge University professor trained under Marshall helped to gain support for his ideas in more conservative quarters.

Particularly noteworthy is Keynes's tendency to introduce possible exceptions or qualifications, with the result that those who are careful and meticulous in such matters could accept the limited doctrine in a limited way.

7. Keynes's persuasiveness was doubtless a factor in estab-

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[1] See above, pp. 747, 758. Cf. *General Theory*, pp. 317, 320, 213–214, 376, 378–379; "National Self-Sufficiency," *Yale Rev.*, 1933; Robinson, Joan, *An Essay on Marxian Economics;* Klein, L. R., *The Keynesian Revolution;* Ayres, C. E., *op. cit.*

lishing his influence. In his shorter writings, his literary style is clear and interesting. He proved able to attract and hold attention. Indications are not lacking that he was good at seeing the opportunity and timing his effort. Also it appears that he was facile and ready to change, using the "experimental approach." Thus in his "The Balance of Payments of the United States" (*Economic Journal*, 1946) he wrote: "No plans will work for certain in such an epoch. But if they palpably fail, then, of course, we and everyone else will try something different." We should not try "to look ahead further than any one can see." But the point that stands out is his knack of putting ideas into attractive form. Like Veblen, he will ever be known by the phrases he coined — by the names he gave the parts of his scheme, perhaps as much as by the appearance of simplicity of the scheme itself.

For all the foregoing reasons, Keynes was able to "put across" ideas for which others had failed to gain recognition.

General Appraisal of Keynes's Thought. — *Contributions.* — Keynes made a number of important contributions to the stream of economic thought. He discovered no new theory. There are no new elements in his system, and probably no new concrete proposals of policy. But his method of combining the elements and policies was new. His terminology was his own. And his influence has been extraordinarily great.

First, among Keynes's contributions should be put his "SYSTEM" of policy. J. M. Keynes fitted together certain used parts to build the machine, and *it* was new.

In doing this, Keynes made a contribution concerning the interactions between demand and supply under varying conditions, particularly pertaining to labor and capital. And while his thought may have been essentially static, as important critics have concluded, he has influenced a tendency toward more allowance for change in the condition of equilibrium.

The different *emphasis* he put on various elements in his scheme is significant. Thus Keynes put the emphasis on demand, rather than on supply, and particularly on the "purchasing power" element in demand. He emphasized the problem of unemployment, and the enterpriser's responsibility in that connection. He emphasized the relation of Distribution to *Consumption*, dwelling on the fact that a decline in money wages may not increase employment or sustain total income. His great emphasis was on the role of government and the possibility of stimulating recovery by government spending to supplement private spending.

As to particular doctrines, the most notable points appear to be (1) Keynes's use of "expectation" as an element in the "marginal-efficiency of capital" and the enterpriser-investor's inducement to invest; (2) his development of the liquidity-preference idea and the psychological conditions which keep interest rates above zero; (3) his emphasis and use of the "multiplier" *as part of a system of control.*

The foregoing appraisal may be supplemented by the following points made by some authorities on Keynes: Harrod says the most important single point is that "income in the community" is dependent on the amount of investment decided upon. Clark appears to think that Keynes made contributions in the neglected area of *total* flow of income and employment. Wright makes the theory of a minimum rate of interest a new and valid contribution. Harris adopts Haberler's emphasis of underemployment equilibrium, and adds Keynes's uses of "expectations."[1] Schumpeter has stressed the "origin of *modern* stagnation thesis."

These positive contributions, though important, do not appear to be fundamental discoveries or additions to the principles of economics such as those made by Adam Smith, Ricardo, Böhm-Bawerk, and Marshall, or by Cantillon, Von Thünen, and Gossen.

In addition, Keynes made negative contributions. He was a severe and effective critic of Marshallian and Pigouvian economics.

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[1] See Harris, S. E., *The New Economics; Keynes' Influence on Theory and Policy*, 1947. This work contains essays on Keynes by a considerable number of economists. Harris is strongly pro-Keynes.

He stirred up fruitful discussions of the nature of credit, interest, saving and investment, and of the part played by money. This has led to a more careful examination of the relation between real and money wages, and of their cyclical movements.

For the rest, he has done economics the service of pushing to extremes certain tendencies commonly found in the prevalent types of "price economics," mathematical economics, and welfare economics. He carried price economics to the logical extreme of circularity, by treating spending (price of goods bought) as the source of income (price of goods sold).[1] He carried mathematical subjectivism to the logical extreme of homogeneity assumption, by assuming that money represents goods (prices remaining equal), including producer goods (reduced to "wage units"[2]). He carried welfare economics to the logical extreme of turning economic science based on actual desire tendencies into a scheme for managing "the economy" so as to socialize demand and make "full employment" the goal.

Shortcomings. — Against such contributions, positive and negative, are to be balanced the shortcomings and errors. These have been suggested by various critics.[3] At bottom, they stem from a certain fundamental bias in philosophy and a sanguine temperament which allowed too many gaps and inconsistencies in logic.

In considering total national income, Keynes did not deal with the distribution of income among the different branches of industry, or between the economic and *non-economic* spending. As a result of putting the aggregate before the parts, he failed to make due allowance for repercussions and "leakages" which result from the reaction of individuals to over-all policies and controls. Forecasts based upon Keynesian models have failed, because the total "national income" is composed of the incomes and spendings of many individuals whose particular desires and anticipations do not in fact lead to actions in conformity with the over-all Keynesian spending policies and controls.[1] Government "investment" often induces individual fears for individual investments. The means required to establish low money rates reduce the individual's demand for money. Thus Keynes's theory is restricted by the very propensities, preferences, inducements, and expectations upon which he tried to base them.

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[1] This point has great importance. As Harris says, Keynes disproves the old theory that falling wages bring rising employment. (He might have added the relation of interest rates to saving and investment.) This is a service. It is a blow to the still prevalent price economics and price-determined ("secondary") demand and supply schedules. It is to be hoped that eventually economists will turn to studies in the causation and determination of value, based on "primary" demand and supply schedules, representing positive desire tendencies (bids) and negative desire tendencies (asked prices). Cf. Haney, L. H., *Value and Distribution*, 1939, pp. 278–292.

[2] The ordinary price of an hour's time put in by an ordinary laborer.

[3] See above, p. 763 f.

From the aggregate approach, there follows the "monetary theory." In lieu of output of goods, Keynes puts total money income. This is also made to represent total "employment," apparently on the assumption that output varies with number of man-hours. Not only is the value of money assumed, but also the value of the product of labor. Thus wages are not considered as really depending on the product of labor.

It does not seem to be an adequate defense to say that Keynes was concerned with aggregates merely as supplementing individualism, that he purposely considered only short-term or timeless equilibria, and that he stated many qualifications. His thought centered on *policy*, and that can find expression only in application. But any applied economics must necessarily extend to the *individuals* and *classes* who or which are the only expressions of social aggregates. It also necessarily runs into the *long-run*. Qualifications butter few of the parsnips of *reality*. After all, the economist chooses the assumptions he makes, and should be aware of the resulting tendency in economic theory. Keynes himself was well aware that it becomes dangerous to apply a theory based on one time and place (say depression in England) to other times and places.

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[1] Keynes foresaw some of these. (E.g. *G.T.* pp. 119 ff.), but proceeded to formulate his scheme as if they might be disregarded or could be overcome.

One respect in which Keynes, like the Neo-Classicists in general, fails to provide an adequate basis for general economic theory is his failure to allow for the "real" costs which enter into individual motivation. He falls back on "opportunity cost" in his essential concepts of "liquidity preference" and "user cost" (depreciation).

One of the more important criticisms lies in the idea of limited investment opportunity. This is one of the least satisfactory parts of the Keynesian scheme, and one which has had an unfortunate effect on policies arising therefrom. Upon whatever assumption based, whether assumptions as to population growth, as to clashing or unintelligent human motives, or as to the possible hostile reactions to proposed government controls which increase the tendency to stagnation, the idea of a sort of fixed investment schedule seems to be unwarranted by theory or fact.

In general, Keynes's *General Theory* has the earmarks of so-called mathematical economics. Despite his own disclaimer in this connection,[1] his thought at bottom rests upon the all-pervading assumption of "other things being equal." Basic is the timeless mathematical technique whereby it is assumed that because one thing (spending) leads to another (income) it *equals* (or should equal) the other, at a given time. This is to say nothing of the statistical fact that totals or averages may be equal, without any similarity as to modes or dispersions.

One of the fruits of this procedure is the definition of "saving." This is defined in negative terms as "not-spending," and that means not spending *now*. Thus the positive content of savings as related to the purpose of investment, and to the future, is lost.

Idealism. — Keynes as a thinker was a pretty extreme idealist, which has much to do with his economic theory and its limitations. Consider the following facts: He considered that men are different, and emphasized hereditary ability.[2] He relied heavily upon intuition,[1] and upon the potency of ideas.[2] He took the existence of goods for granted, thus being a subjectivist. He put consumption before production. He accepted the reality of aggregates. He believed in the efficacy of government controls. He was optimistic about these as a means whereby we can work out our own salvation, and believed that "natural" tendencies can be changed.[3] He considered it a "duty" of the state to order the current volume of investment.[4] He had, as a main purpose, social reform.

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[1] *G.T.*, pp. 297–298.

[2] *The Nation and Athenaeum*, Mar. 27, 1926.

Any radicalism in Keynes's thought, then, was not like that of Marx based upon a materialistic interpretation of history — not upon the compulsion of the material environment. In this fact lies a certain consistency, lacking in Marx's thought; but also a certain lack of touch with historical realities. By the same token, Keynes's thought is less revolutionary in its means and methods.

But Keynes's ideals of "full employment" and "socialization of demand," and his reliance upon the "wage unit" for social homogeneity,[5] show some tendency toward collectivism. This has been recognized by certain radicals. *The general effect of the prevalence of Keynesian doctrine has certainly been to blur the line between collectivist and individualist economic theory.*

The Future.[6] — The survival of the Keynesian system, as formulated by Keynes, will depend upon the success attained in the application of the policies which express it. This, in turn, rests upon the correctness of the forecasts of national income and business conditions that will be based on Keynesian "models." In neither respect can it be said that experience has indicated success.

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[1] *General Theory*, pp. 249, 366, 371.

[2] *Ibid.*, p. 383.

[3] *Ibid.*, p. 254. Cf., "The Balance of Payments of the U.S.," *Ec. Jr.*, 1946, p. 186.

[4] *Ibid.*, p. 320.

[5] Together, these come to much the same thing as Marx's "socially necessary labor time." But Keynes believed strongly in "personal liberty" and "some measure of individualism." He criticized the "homogeneous or totalitarian state" for causing a loss in the "variety of life."

[6] For a more optimistic statement cf. Wright, D. McC., "Future of Keynesian Economics," *Amer. Econ. Rev.*, 1945.

Even if it should prove possible to decide which of the differing and diverging followers of Keynes actually wears the mantle of the *General Theory*, there would remain the question of adjusting the income of one pressure group within a nation to the spending of another. And beyond that, lies the problem of adjusting the income of one nation (say Britain) to the spending of another (say America).

CHAPTER XXXVIII

"GENERAL-EQUILIBRIUM ECONOMICS" AND ECONOMETRICS[1]

The idea of solving price problems by mathematical equations never died. It matured in the seventies of the last century, with Jevons and Walras. It was kept alive by the Lausanne School and Fisher. Then it grew and spread lustily under much the same conditions that bred the Keynesian system — war, depression, and "the managed economy." And much as Keynes's thought had to be a revolt against the production-and-cost approach of the Classicists, so the thought of Hicks and the general-equilibrium economists had to be a revolt against the marginal-utility approach of the Neo-Classicists.

GENERAL-EQUILIBRIUM ECONOMICS

General Nature of the Theory. — The general-equilibrium economics of the twentieth century is the direct outgrowth of the thought of Leon Walras and the mathematical subjectivism discussed in an earlier chapter. Thus it is based upon an assumption of the primary importance of the subject, man, and proceeds to ignore the importance of changes in the technological conditions of the environment. Goods are assumed to exist.

Beginning with the idea that scarcity, or *rareté,* is a function of desire, the thought goes on to make "value" a matter of preference between objects of desire, considering only positive desires — desires for goods. Thus "value" is identified with

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[1] Fellner, W., "Employment Theory and Business Cycles" in *A Survey of Contemporary Economics* (Ellis, ed.), 1948; Heimann, *History of Economic Doctrines,* 1945, Chap. VIII; Ohlin, B., "Some Notes on the Stockholm Theory of Savings and Investment," *Ec. Jr.*, 1937; Hicks, J. R., "Recent Contributions to General Equilibrium Economics," *Economica,* 1945; and works in following footnote references.

"price"; for a "preference" is a pricing process, a ratio between one good and another. Thus the idea of "mutual determination" arises. Goods constitute "reciprocal" demands for one another. Or one good limits the demand for another, since in order to obtain one good, man must give up another — the "opportunity-cost" idea.

Thus, beginning with the idea of an equation between two goods, there develops the idea of (1) a series of equations covering all possible quantities of the two under given conditions, and (2) a set of multiple equations covering the quantity relations among all goods at a given time. The first is the idea of the scale of preferences, or the "indifference curve." The second is the idea of a general equilibrium among all preferences.

The highly abstract character of such thought is to be noted at once. It *assumes* many important conditions of economic life, without attempting to explain or to measure them.

It assumes that goods exist.
It assumes the existence of exchange.
It assumes the total quantities exchanged.
It assumes that money has value.
It assumes rational choice.
It assumes homogeneity among all goods.
It assumes that no real costs need be allowed for.
It assumes constant conditions in time.

In part, this abstraction, or economics of assumption, is shared by the Austrian School of Neo-Classicism, which, as shown in another place, is also subjectivist. The "Austrians" are rationalistic; they treat cost as "utility cost"; they regard producer goods as deriving value from finished goods. But the general-equilibrium thought of Walras and his followers goes beyond the abstraction of Böhm-Bawerk and his followers. Notably, it extends to money, to time, and to the limits of the whole system: It makes money a unit of account, treats time as a constant, or ignores it, and sets up a closed system.

The last point is particularly significant. The general-equilibrium theory runs to macro-economics; while the Austrian marginal-utility theory centers on micro-economics — on inter-individual values. The mathematical concept of all consumer goods exchanging for all producer goods, or of all money exchanging for all other goods, is macro-economics. So is the idea of controlling the general price level by manipulating money rates or by government spending. But these things differ widely from the Austrian imputation of the value of near goods to remote goods, or the imputation of the value of gold in the arts to gold as money.

And accordingly, the school of Walras, being essentially mathematical, must go to great lengths in assuming no change in conditions, so that sweeping assumptions of "other things being equal" can hold good. The Böhm-Bawerkian logic may be over-rationalistic, but it can be adapted to differences among men or goods and to changes in condition.

In addition to the Walrasian mathematics, one can see in the twentieth century general-equilibrium thought several other elements of more or less distinct significance. These concern time-period analysis, the treatment of money as credit, and the use of some "scheme" or "model" for determining the parts of the whole "system." Finally, in the early 1900's, came the problem of collectivism in the form of the question: Which one of several possible systems of general equilibrium will give the optimum allocation of society's resources?

Historical Background. — From Sismondi (and back of him, Cantillon and the Physiocrats) may be dated the idea that the spending of one time period is the income of another time period. As general-equilibrium theory grew in scope, it had to take up "period analysis."

From Macleod, and others of the narrow exchange-value school,[1] came the concept of money as mere unit of account, or *numéraire*, which is so important a part of the general-equilibrium scheme.

From Wicksell and Keynes, together with the social and economic conditions which induced their systems of thought, came the emphasis of the part played by saving, investment, and interest in the national income, and the relation of consumption spending thereto. These things not only influence the items set up in the equations, but also shape any content of "ideology" that may be involved.

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[1] See above, Chap. XXV; particularly pp. 517, 518.

And, at about the same time, the attempt to generalize the concept of equilibrium led Pareto to consider the problem of collectivism — the optimum allocation of the total resources of a society. This question led to apparently insoluble problems, and Pareto fell back on ethical judgments.

Briefly, the leaders in the comprehensive system of equilibrium theory, in the direct line of descent, have been L. Walras,[1] V. Pareto,[2] and E. Barone.[3]

Contributing independently to the theory have been F. Y. Edgeworth,[4] I. Fisher,[5] and P. Wicksteed.[6] Edgeworth is perhaps the inventor of the indifference curve. Fisher independently developed the idea of market equilibrium dependent upon the directions of indifferences, any two of which could be integrated. Wicksteed expounded a system of proportional utility for allocating demand among various goods.

Carrying on, perfecting, enlarging, or applying, with much use of mathematics or statistics, the most notable have been: Cassel, Robertson, the Stockholm School (Lindahl, Myrdal, Ohlin), J. R. Hicks, J. Tinbergen, W. Leontief, L. R. Klein, and G. Tintner. And among these more recent economists, one finds those who have gone furthest in discussing the general-equilibrium technique as a means of implementing a collectivist economy or a "welfare state."

The bearing of individualistic thought and value theory upon general-equilibrium theory is noteworthy. Several economists, notably Marshall, had ideas that might have led to such theory, but were restrained by a recognition of the basic importance of the individual's subjective values. At bottom, the difference between the Austrian thinkers and Walras or Pareto lies in the attitude toward the individual's schedule of marginal utilities. The one must be concerned with their source in human psychology. The other deals only with their manifestations in "preferences" or prices. Thus the Austrians lean toward a competitive system as a basis for free individual choice. The Walrasians in time have come to show a readiness to accept a managed economy as a basis for the conditions upon which their closed systems of general equilibrium depend.

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[1] *Éléments d'Économie Politique Pure*, 1874.

[2] *Cours d'Économie Politique*, 1896; *Manuale di Economia Politica*, 1906 (French, 1909).

[3] *Principii di Economia Politica*, 1908; "The Ministry of Production in the Collectivist State," in *Collectivist Economic Planning*, Hayek, ed., 1935.

[4] *Mathematical Psychics*, 1881.

[5] *Mathematical Investigations into the Theory of Value and Prices*, 1892.

[6] *Common Sense of Political Economy*, 1910.

It is no mere accident that J. R. Hicks in his famous 1934 article wrote that the advantage of the indifference curve is that it frees the state from the shackles imposed by a recognition of the importance of individual marginal utilities.[1]

Those economists much touched by the Austrian marginal-utility theory of value (or other Neo-Classical theory) have made only limited use of the indifference-curve approach — Wicksell, Wicksteed, and, in their different ways, Fisher and Schumpeter.

Finally, among these general conditions affecting general equilibrium, the importance of the Keynesian "model" is to be stressed. Perhaps Wicksell and the Stockholm School would have served as well in this respect. But in fact, the "scheme" provided by Keynes's *General Theory* has been most influential. It has supplied the form for the "principle of duality" *in the aggregate* (Income = Spending; Spending = Consumption + Investment) that is well calculated for use by the mathematician. Add the homogeneity of the "wage-unit" criterion of production, and the convenience of "the multiplier" and the "inducement to invest" mechanisms, and it is no wonder that, at least in the English-speaking world, general-equilibrium economics is so largely the economics of Keynes's *General Theory*.

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The Leaders and Their Contributions. — *L. Walras.* — In Leon Walras's thought (1874), one can find much of the background prepared by J. B. Say — the emphasis of buying and selling as the main problem, with goods conceived of as having "inherent" utility, and costs treated as entrepreneur payments including rent and profit.[1] Walras's basic ideas have been presented in outlining the nature and rise of mathematical subjectivism in Chapter XXX and the introduction thereto.[2] Here it is necessary to state those of his ideas which have most directly influenced the development of general-equilibrium theory of J. R. Hicks and the Stockholm School.

Starting from the concept of value as a ratio between *raretés* (scarcities) inherent in goods (thus begging the question of marginal utility), Walras formulated a general theory of price in terms of a series of equations between the payments for goods exchanged.

This theory he generalized to include not only all finished goods, but also producer goods and money. Money, Walras treated as a *numéraire* — or a nominal thing representing goods — units of account. Its *rareté* was assumed. Thus it was introduced into his system of equations as one of a series of goods. Then producer goods (such as capital) were treated so as to be the equivalent of the consumer goods which are expected to be yielded by them. Thus they are also introduced into the system of equations.

The general idea is that the total money payments for the factors of production equal the total money demand for the products. This assumption rests upon the underlying assumption of the same *relative* prices for the factors, now and in the future. Thus the interest rate is assumed to be the anticipated net yield of capital (sales of products minus amortization cost) divided by current expense of producing the capital good.

V. Pareto. — Vilifredo Pareto (1848–1923) was an engineer interested in politics. His mathematical work attracted Walras, who selected him as his successor at Lausanne. So began the "Lausanne School." Pareto published his two volume *Cours* in 1896–1897, in which he undertook to expound and develop the Walrasian system of general equilibrium. He stressed the interrelation, homogeneity, and measurability of all quantitative economic phenomena. But he found difficulty with the Walrasian basis of measuring economic forces. Also his interest in the social problem of inequality in wealth seems to have bothered him.

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[1] Cf. above, pp. 355–358.

[2] Pp. 581–586 should be reviewed here.

The result was his *Manuale* (1906), in which he abandoned the idea of value, as distinguished from price, dropping quantitative reference to *rareté* or utility. Adopting from Fisher the idea of scales of preference, and from Edgeworth (and Marshall) the "indifference curve" of substitution, he developed the idea of a demand curve for any commodity which, subject to various assumptions and qualifications, would represent the preference for that commodity with reference to all other commodities in a given "system."[1]

Assuming rational and free choice, this conclusion is arrived at somewhat as follows:

First, a given total income is assumed; then

Second, a given system of prices.

Third, at these prices, an income is assumed to be the equivalent of an aggregate of two goods, or sets of goods.

Fourth, the total income is assumed to be spent for the total quantity of the goods in question, and on no others.

Fifth, "preferences" are inferred from the *relative* amounts spent on the two goods (at the given prices). The "preference" for one good is the amount "*not-spent*" *on the other*.

Thus one can ascertain the quantities of one of the two goods that will be bought (at any price) by examining the indifference curve, since it marks the various proportions of the assumed total expenditure of income which will be not-spent on the other good.

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[1] Pareto's theory was developed and refined by E. Slutsky, "Sulla teoria del bilancio del consumatore" (Theory of Consumer's Choice), *Giornale degli Economisti*, 1915. See Allen, R. D. G., "Professor Slutsky's Theory of Consumer's Choice," *Rev. of Econ. Studies*, 1936.

And if money be taken to represent all other goods, the money price of the given good may be similarly read off.

Finally, a "map" of similar indifference curves, each curve representing a different total combined quantity of the two goods, may be drawn. These different curves are higher or lower than the one with which we start, thus showing which aggregate quantity is preferred, though not *how much it is preferred.*

The system may be extended to include all goods, including producer goods, since the latter may be regarded as the cost price of the products, so that the two will tend to be equal.

This suggests the question: What distribution of the resources in a society gives the optimum results? A general-equilibrium theorist might consider that under competition, free individual choice would lead to the maximum want gratification, by minimizing the not-wanted expenditures. Walras seems to have tended to this conclusion. But even he, in recognizing the necessity of free competition, advocated land nationalization so that all might be free to choose location.[1] And Pareto, as noted on an earlier page, may be said to have ended his efforts by swinging to nationalistic control. He at first sought to ascertain whether a competitive or an authoritarian system would most nearly attain the optimum.[2] But obviously this problem forces one back to utility or satisfaction derived from consumption, which according to his basic theory is not measurable. He concluded that, for a solution, we must resort to some non-economic criterion — ethics or politics.

This phase of his thought was carried further by E. Barone (d. 1924).[3]

Here will be passed over Cassel, whose thought has been briefly discussed under the earlier "mathematical subjectivism," and Schumpeter who, while accepting in part the Walrasian approach in his *Wesen und Hauptinhalt der Theortischen Nationaloekonomie* (1907), does not appear to have carried on or added to it.

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[1] "Differential" rents are hardly possible under the homogeneity required for "general equilibrium."

[2] *Cours d'Économie Politique*, Lausanne, 1896, Vol. II, pp. 90 f., 364 ff.

[3] *Giornale degli Economisti e Revista di Statistica*, 1908 (translated as "The Ministry of Production in the Collectivist State," in Hayek (ed.) *Collectivist Economic Planning*, London, 1935).

D. H. Robertson.—This brings us to D. H. Robertson and the members of the Stockholm School, all of whom were much influenced by Wicksell. Both are of particular interest because of their attempts to deal with the time factor in general equilibrium, by means of the so-called "period analysis." Both may be said to have developed the savings-investment approach to a circular-flow type of monetary economics.

Robertson's[1] equilibrium assumes time lags to be necessary, and allows for them. Indeed he and his Swedish contemporaries consider equilibrium not as a stationary condition, but as one of change or "process." He assumes time periods to be such that the income of one period (that is, the value of production in that period) is spent in the next period. (He uses a day.) On this basis, his "model" is set up as follows:

The consumption spending in period 2 is determined by (a) the income and (b) the propensity to consume in period 1 (*ex post*). The controlling elements are saving and investment, the formula being: consumption + investment in period 2 = income from period 1. Equilibrium, in the Robertsonian sense, is attained when the income of period 1 = the spending of period 2.

Thus, contrary to Keynes, Robertson holds that it cannot be assumed that current income equals current spending. His general assumption is that income will change from period to period. What, then, about anticipated or planned spending? Here, too, the time factor makes a difference: we cannot assume that planned income for a given future period will equal the spending planned for that period. His "model" does not require that expectations turn out to be correct, though this may occur.

Expectations appear as implicit relations between the experience of the past and the realization of the future.

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[1] See above, pp. 680, 752. Cf. *Banking Policy and the Price Level*, 1926; "Saving and Hoarding," *Ec. Jr.*, 1933; "Survey of Modern Monetary Controversy," in *Readings in Business Cycle Theory*, 1944.

Robertson has done good service in suggesting refined theoretical tools and in constructive criticism. He is fundamentally less radical than many of the neo-general-equilibrium theorists, clinging to certain valuable parts of the Marshallian system and the supply-demand analysis of money value.

The Stockholm School. — The Stockholm School,[1] or Swedish School as it is sometimes called, developed during the depression of the nineties under the influence of Wicksell, whose *Interest and Prices* (1898) may be thought of as its earliest expression. Wicksell undertook to deal with the general price level through income analysis, without relation to cycles. He taught that consumption is related to income; and emphasized the relation between saving and investment, though not holding that they must be equal.

Cassel, though not a member of the School, also had some effect in introducing the Walrasian approach and an a-Classical monetary economics.

G. Myrdal, in 1927 wrote on *Pricing and the Change Factor*, in which work he dwelt on uncertainty as a factor in prices, taking a step toward dynamic analysis. He criticized Wicksell's emphasis of the "natural" rate of interest in a monetary society, and argued that the main criterion of equilibrium is that *ex ante* or planned savings and investments must be equal.

E. Lindahl in 1930 published *The Means of Monetary Policy*, showing Robertson's influence and developing a period analysis. He starts from the equation: Income − Saving = Consumption spending. His *Theory of Money and Capital* is translated (1940).

B. Ohlin[2] explains the School's thought as being an attempt by period analysis to attain a more realistic explanation of economic life than Keynes did. He states that spending (planned and actual) determines changes in employment and prices, and that planned spending is to be determined by expected income, expected prices, and expected needs. The amount of savings in period 2 (which will affect the spending) is thought of as related to the expected income in that period, not to the income of the preceding period 1. By definition, savings equal investment.

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[1] Cf. Ohlin, B., "Some Notes on the Stockholm Theory of Savings and Investment," *Ec. Jr.*, 1937.

[2] Ohlin tells of four studies on cycles, employment, and financial and monetary policy published in 1933–1934 (prepared by himself, Hammarsjöld, Johansson, and Myrdal), and a combined report on *Remedies for Unemployment* in 1935. Here, before Keynes, is found the idea that flexible wages cannot be relied upon to bring full employment, that interest rates, fixed by bank authority, are, along with other prices, merely one element in a complex set of determinants. The report was written by Hammarsjöld.

The Stockholm or Swedish School's model is set up as follows: The consumption spending in period 2 is determined by (a) the expected income and the expected propensity to consume in period 2 (both *ex ante*). The controlling elements are, immediately, the expected investment in period 2 and the actual investment in period 2; that is, the difference between investment *ex ante* and investment *ex post.* But any such difference appears to result from a difference in saving (e.g., inventories). Equilibrium, in the Stockholm School's sense, is attained when expected income equals realized income in period 2. Then, by definition, expected saving in period 2 will equal expected investment.

Thus *expectation* is emphasized, and is explicit in the formal model. It is not assumed to determine in any given case, but is assumed as a *tendency*. Planned income and spending are not assumed to equal actually realized income and spending in any particular period. *Ex post* may differ from *ex ante* as a condition of "process" or change. But when they are equal, a special condition of "monetary equilibrium" exists.

"Period Analysis." — The rationale of the period or sequence analysis, with particular reference to the Stockholm School, is this: At the end of period 1, a survey of the realized income and expenditure is made *ex post.* This, however, explains nothing as to the determination of action. Therefore, a study is made of the expectation of period 2, which occurs at the beginning of that period. These *ex ante* expectations, compared with the *ex post* survey of period 1, are considered as *determining* action in period 2. Thus continuity is provided, as each period *starts* with a comparison of *ex post* results and *ex ante* plans, which comparison *affects* the period's performance.

In this way, the attempt is made to deal with change — with process. Period analysis does try to keep the past separate from the future. It does provide a point of view at which past and future join in the present. Thus it allows a truer concept of anticipations and of the time factor, including the *speed* with which the process of change occurs.

At least, time is not forgotten by assuming instantaneous adjustments.

But to recognize a problem is not to solve it. Just so, to separate a past period from a future period is not to determine the relations between the two.[1]

The past and the future overlap in the measurable present. We see the past in the light of our experience as it is now, and of our hopes for the future. We see the future in the light of past experience, and our hopes for it are partly based on the past.

By the same token, time periods are unreal. Neither our memories nor our anticipations are limited to two adjacent periods. Our motives "now" include memories from many time periods. Our anticipations for period 2 are but parts or our anticipations for periods 3, 4, 5, and more.

Moreover, memories and anticipations are both evolving — irregularly but always changing.

Periods that may (temporarily) fit one case or set of data, do not fit another. Thus the period analysts are forced to distinguish different cases, and their models are applicable only to oversimplified cases. This is a sure indication of lack of a basis in fundamental causes.

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[1] Attention should here be called to the valuable work of the Swedish economist, Johan Åkerman (*Ekonomisk Teori*, I. *De Ekonomiska Kalkylerna*, 1939, and II. *Kausalanalys av det Ekonomiska Skeendet*, 1944; and *Das Problem der Sozialökonomischen Synthese*, 1938). I have had to rely on reviews of these works, but clearly they suggest the fundamental criticism of the general-equilibrium approach and the attempt to introduce dynamic conditions by period analysis. Åkerman criticizes both abstract static theory, based on utility, and so-called dynamic theory which leaves out reality. The limitations of dynamic theory are shown to be due to the long time required for cases to work out.

Thus the sequence analysis is not and cannot be truly general. How can one tie the *whole* of a past period in which changes in technology and taste occurred, to the *whole* of a future period as to which all one can do is to estimate a more or less wide *range* of possibilities or probabilities? Either the thinker leaves out much of the content of life, or he makes the periods so short that nothing much can happen in them!

All this is to say nothing of the limited techniques of aggregate or macro-economics and of monetary economics, and the dangerous abstraction and oversimplification which are inherent in both. Such economics may make it seem easier either to ignore time or to chop it into unreal segments; but they make the period analysis all the less applicable to the world of reality.

J. R. Hicks. — J. R. Hicks probably has come the nearest of any of the general-equilibrium theorists to stating his thought in a form that is intelligible to a layman — probably the nearest to reducing it to comprehensive general statement.[1] In this, he has been aided by a certain broadmindedness and "common sense" which, at points, lead him to introduce "practical" matters, and save him from going to ideological extremes.

Hicks is in the direct line from Walras, through Pareto. He recognizes that Walras did about all that is required to set up the problem, and accepts his theorem. He accepts the Paretian indifference-curve analysis, with some refinement of the qualifications. (Hicks always seems to be aware of the many qualifications imposed, and it is to his credit that he states them clearly.) He recognizes a debt to Wicksell.

It is of interest, however, to note that he considers Marshall's value theory more useful than Pareto's.

He goes on to attempt a dynamic system, incidentally stating that Keynes had anticipated much of his thought in this respect.[2] He treats the price problem as an interrelation between markets; that is, as an equilibrium among pre-existing prices. With much abstraction, by mathematical methods, and in terms of money prices, he undertakes to develop the laws of a price system embracing many markets under "dynamic" conditions.

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[1] *Value and Capital; an inquiry into some fundamental principles of economic theory*, Oxford, 1939.

[2] Since some have criticized Keynes for not being truly dynamic, one may anticipate some question on this score.

Hicks shows the tendency so common among so-called "dynamic" economists to regard *any* condition as one of temporary equilibrium, so that, in an important sense, the kind of economic system with which they are concerned is *always* in equilibrium. But in a broader sense ("over time," in the sense of more than one time "period"[1]), equilibrium means supply equal to demand at *anticipated* prices, whether constant, or changing at an expected rate.[2]

The conditions of stability in equilibrium are: perfect competition, no institutional interferences (as by government), and absence of uncertainties in time. But in large part, these are also the condition of Hicks's dynamic system, his work being avowedly based upon the assumption of perfect competition and private enterprise as limiting conditions. Thus the only real problem left for such dynamics as Hicks's is that of uncertainty in time — the problems of saving, investment, enterprise, and speculation.

Incidentally, one notes that Hicks appears to accept the limitation of private enterprise with considerably more complaisance than did Keynes. It is characteristic of the two "schools" that Hicks in writing of Keynes and "his followers" says "it does not seem clear that we need go the whole way with them, for the view of capitalism which is included in their work contains other elements besides those which are necessarily implied in the transition to a dynamic theoretical basis."[3]

Hicks's price theory is straight indifference-curve technique, limited to two goods regarded as partial substitutes or compliments. It is limited by all the assumptions noted on a preceding page (782). He undertakes to deal with markets divided into four main kinds: finished products, factors of production, services, and intermediate products.

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[1] The difficulty of all this is seen in the question, why not make the time period a minute? Or why not a generation?

[2] *Value and Capital*, pp. 131–133. See criticism by Samuelson, P. A., *Econometrica*, Apr. 1941; Metzler, L. A., *Econometrica*, 1945.

[3] *Ibid.*, p. 294.

His main concern, however, appears to be with capital and interest, and centers in Chapter XII of *Value and Capital.* Rejecting "real capital" theories of interest, he states that, while "capital" may be regarded either as loanable funds (and securities) or as money, he favors the latter usage, as not involving the differences of time periods — and the complexities of "systems" of different interest rates.[1] Also it seems to have to be more closely related to price.[2]

There follows an outstanding attempt to reformulate interest theory in dynamic terms. As usual in general-equilibrium theory, the basis is found in "opportunity cost." The assumption is first made that money has "general acceptability" — objective value. But "other securities"[3] do not have such complete liquidity. Thus the tendency is to prefer money to "securities," and a premium has to be paid to induce people to lend money. That which makes people prefer money is what explains interest. This is much the same as Keynes's "liquidity preference," but Hicks adds costs of investment, and specifically lists risks of future changes in interest rates themselves.

Differences among interest rates, always a thorn in the logic of the economist who tampers with time, Hicks would dismiss with the assertion that they arise from expectations of differences in the future courses of short-term and long-term rates.[4]

In his "conclusion," Hicks accepts a sort of innovations theory of business cycles and suggests that the state should moderate economic fluctuations by public spending and monetary policy. He expresses some fear of "secular unemployment," admitting that if it were to develop it might prevent the survival of free enterprise.

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[1] It is interesting to note the tendency to escape from time, by assumption.

[2] Note that this may assume the value of money, and that such value is a constant.

[3] Hicks, under criticism (by O. Lange), later changed "securities" into "bonds."

[4] Hicks, *op. cit.*, p. 152.

But he dissociates himself from the tendency of Keynes to mix anti-capitalist ideology with his economics. Keynes was too much concerned with ends. Hicks's interest is in method as a means.

International Trade. — General equilibrium theory has been applied to foreign exchange and international trade, largely (not entirely) under the influence of Keynes's theory of income and employment and the theories of Hicks and the Stockholm School. The tendency, led by Haberler and Leontief (with Viner notable as a critic), has been to apply the concepts of opportunity cost or the indifference-curve analysis, and to emphasize the "optimum" adjustment rather than mere stability.[1] Ohlin's substitution of the idea of the "economic region" for the national economy has had a great effect on international trade theory. The idea was further developed by A. Lösch.[2]

ECONOMETRICS[3]

Closely associated with general-equilibrium theory is that phase of economics which is known as "Econometrics." This may be defined as the attempt to apply theoretical hypotheses concerning quantitative relations among economic phenomena by means of the mathematical treatment of statistics.

The mathematical economics of Walras and Pareto was so abstract, and so full of conditional propositions and qualifications, that its lack of real content soon became obvious even to those who saw its possibilities.

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[1] Some leading contributors are: Ohlin, B., "Transfer Difficulties," *Ec. Jr.*, 1929, *Interregional and International Trade* (1933); Leontief, W., "The Use of Indifference Curves in the Analysis of Foreign Trade," *Quart. Jr. Econ.*, 1933; Haberler, G., *The Theory of International Trade*, 1936; Harrod, R. F., *International Economics* (rev. ed.), 1939; Mosak, J. L., *General-Equilibrium Theory in International Trade*, 1944; Metzler, L. A., "Underemployment Equilibrium in International Trade," *Econometrica*, 1942, and "The Theory of International Trade" in *A Survey of Contemporary Economics* (Ellis, ed.), 1948; Viner, J., *Studies in the Theory of International Trade*, 1937.

[2] *Die räumliche Ordnung der Wirtschaft*, 1940.

[3] Davis, H. T., *The Theory of Econometrics*, 1941; Leontief, W., "Econometrics," in *A Survey of Contemporary Economics* (Ellis, ed.) 1948; Grayson, H., "The Econometric Approach: A Critical Analysis," *Jr. Pol. Econ.*, June 1948.

Among these, Professor Irving Fisher was outstanding. His *Purchasing Power of Money* (1911) was an early attempt to bring more reality into the abstract formulae of equilibrium economics. H. L. Moore's *Laws of Wages* appeared at about the same time. Finally, in 1930, Fisher became the first head of the Econometric Society, and the publication of *Econometrica* followed in 1933. Other early workers in this field were: P. H. Douglas, H. Schultz, R. Frisch, and J. Tinbergen, the last named being especially noteworthy as bringing a dynamic general-equilibrium approach to bear upon business cycle theory.[1] A considerable number of able men are at work in the field at the middle of the century.[2]

Econometrics concerns the formulae to be used in analyzing random economic variables. Thus, in the last analysis, it brings us to the theory of probability. The study of the complex phenomena of actual economic life is attended by many errors of observation, and by inability to distinguish many independent variables. Therefore, as Leontief explains, econometricians are largely concerned with the treatment of random variables. This they attempt, either by the probabilitistic approach of assuming some system of "normal" distribution, or by splitting the observed variable into two elements, "true," and "error of observation."

Much of the work is not intelligible to those who are not able to follow involved mathematical processes.

Econometrics has thriven on Keynes's system,[3] which provides a basis for dealing with aggregates by using a few strategic variables. And some vagueness of the Keynes formulation allows setting up different statistical "models" to suit conditions which seem to be different. The recent work has mostly centered in the formula: Income = Spending, thereby bringing in the variable, Saving.

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[1] *Statistical Test of Business-Cycle Theories*, I. *A Method and its Application to Investment Activities;* II. *Business Cycles in the United States 1919–32*, Geneva, 1939.

[2] United States: Klein, L. R., Leontief, W., Tintner, J.; Scandinavia: Frisch, R., Haavelmo, T., Wold, H.; Holland: Koopmans, T., Tinbergen, J.

[3] Keynes himself was sceptical of the use of Econometrics for applying his "model" (*Ec. Jr.*, Sept. 1939). It may be that this sprang from a feeling of uncertainty as to the exactness of his *General Theory* diagnosis.

The so-called "national income approach" appears in the budget studies of A. Smithies, A. G. Hart, J. L. Mosak, and others, and is much influenced by the Keynesian system.

The more theoretical work of building systems of "general equilibrium," seeking to present complete systems of equations covering all economic variables, has been developed by W. Leontief,[1] G. Tintner,[2] and L. R. Klein,[3] and by the Cowles Commission.

Concerning Econometrics in general, the same caution that applies to general-equilibrium and mathematical treatment of economic data is required:

The conclusions are no sounder than the *a priori* assumptions or reasoning that usually precede. Occasional or new factors not taken into account in the models seriously affect the results. If economic theory or ideology be involved, as is often the case, the statistics and mathematics should not be allowed to cover that fact, or to "justify" the result.

To fill the empty boxes of abstract theory with "statistical data" may add little. Such data often lack definite meaning, or they may be perverted. They have a quality, and are themselves abstractions. They change in meaning, and cannot be moved about from place to place or time to time as mathematical units assumed to "remain equal." Irregularly recurring changes in production and distribution disrupt econometric forecasts. Uncontrollable and highly complex phenomena (weather, strikes, consumer responses, etc.) often can not be treated as random data subject to probability theory or coefficients of correlation.

The data used being largely aggregates or totals, there is constant danger of such differences or variations among the parts of which the aggregates are composed that the *meaning* of the total is changed. It does not follow that a change in total input will cause a proportionate change in output.

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[1] *The Structure of the American Economy*, 1919–29, 1941; "Econometrics" in *A Survey of Contemporary Economics* (Ellis, ed.), 1948.

[2] "Multiple Regression for Systems of Equations," *Econometrica*, 1946.

[3] "The Use of Econometric Models as a Guide to Economic Policy," *Econometrica*, 1947.

Much of the work is based upon preconceived structural relationships, preliminary decisions concerning the inclusion of variables in the system, and probabilistic assumptions concerning errors.

When consistently correct forecasts come to be made on the basis of the econometrician's "models," Econometrics will have demonstrated its value.

GENERAL APPRAISAL OF GENERAL-EQUILIBRIUM ECONOMICS[1]

It is to be observed that general-equilibrium economics does not necessarily lead the thinker to any particular "ideology" or attitude toward the social problem. Its techniques may be, and sometimes are, used without bias with reference to conservatism or radicalism.

Unquestionably, too, the statistical analysis involved may be of practical value in the application of "any given" policy.

It has been an important service to have helped to integrate the theory of value of money with the general theory of value.

These statements are to be taken for granted; and where scientific hypotheses can be scientifically tried out experimentally for the purpose of testing their truth objectively, the great service of the general-equilibrium school of economics will be apparent to all.

In part, the limitation of the basis for such theory has been pointed out in treating mathematical subjectivism: it assumes the existence of goods and exchanges among them, thus "escaping" from the problem of production and cost of production.

This limitation is associated with its empiricism. It does not attempt to deal with causation. It either reasons from the past (*ex post*) by projecting time series into the future, or assumes constant conditions. Much of the "anticipation" factor, or

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[1] Attention is again called to the fundamental analysis of the problem of dynamic economics made by the Swedish economist, Johan Åkerman. See above, p. 792 n.

"expectation," is either statistical projection or betting on chance occurrences. Or when Hicks introduces "sensitivity" of individual reactions, and judgments as to "normal"; and Lange refers to personal ideas about the most probable values and the "practical range" of expected prices,[1] it appears that they are just bringing in subjective valuations of the kind the general-equilibrium theorist is trying to eliminate. Moreover, they may imply that all individuals have the same ideas. But there is no recognition of subjective values, or the individual differences in interpreting the same conditions; and no explanation of the judgments of the forces operating to cause changes.[2] If "expectation" is more than a mere reaction equation such as a thermometer shows in registering temperature, how much more? How does it fit into the price equation?

The foregoing suggests the abstractions of the general-equilibrium theory, one of the main abstractions being that concerning time. This limitation confronts one at every turn. No allowance is made for changes in technology or in tastes. Differences in the durability of capital goods are ignored, or are treated by assumption of uniformity. The troubles experienced in treating interest as a single rate, or as a "structure" or "system" of rates, is illuminating.

The closely related reliance upon mathematical method and the "principle of duality," call for attention at this point. General-equilibrium theory appears to rely upon the concept of "mutual determination." In a mathematical sense, $1 = 1$, which is equivalent to saying that 1 is the same as 1. All "1's" are identical. But this throws no light on causation or the *conditions* of change. When we say demand and supply are "in equilibrium," we thereby imply that they are two different things. They are not identical. They do not determine one another.

Each economic quantity has the economic *quality* of importance or value, the conditions of which change — the "forces" that determine. These cannot be reduced to terms of homogeneous goods or to money units having a constant value. In general, mathematics can hardly be used to deduce qualitative conclusions from qualitative assumptions as is required in dealing with economic data.

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[1] Lange, O., *Price Flexibility and Employment*, 1944.

[2] Cf. Lachmann, L. M., "The Role of Expectations in Economics as a Social Science," *Economica*, 1943.

Admittedly there are difficulties in basing a theory of objective value upon marginal utility.[1] But is an escape to be found in the substitution of "preference"? This is but a resort to the negative of an indefinite positive; for "preference" is known only by not-choosing some substitute good. "Indifference" is not-choosing and implies not-wanting. But what does not-wanting mean if we do not know what wanting itself is? The Austrians try to get rid of the disutility cost of labor by setting up its negative as a desire for leisure. Now the followers of Pareto try to get rid of the utility of any one good by setting up its not-utility (indifference) with relation to another good.

And the whole process rests upon the limits of an assumed total, of which each of the two goods is a part (as a "substitute" for or "complement" of the other). Nor is there any explanation of such a total. Much the same can be said of the aggregate national income; and much as macro-economics is able to make no adequate allowance for the individual "income effects" and "leakages" that occur when the total national income is changed, so the micro-economics of the indifference curve cannot account for the individual's preference for one collection of goods over another. It falls back either on total satisfaction (utility) or on authority — on some subjunctive value.

In other words, having no concept of measurable "force," the general-equilibrium theory has to assume either identical goods or identical dollars-worth or pounds-worth units of goods. This is in order to get the fluidity of substitution their system requires. The purchasing power of money is assumed. Then all prices other than that of a given good (the unknown) are assumed as constants.

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[1] These difficulties, however, are in the author's opinion largely the result of the erroneous concept of "utility" on the part of those who have most relied upon it. If utility be conceived of realistically as the motor tendencies of the human organism, the unreality of hedonism and the limitation of the assumption of rationality both vanish. The problem of measurement becomes soluble in terms of choice. And disutility, or real cost, as a *negative* desire tendency comes into its own. See Haney, L. H., *Value and Distribution*, 1939, Chap. III, pp. 232–241.

And so we come to the concept of equilibrium itself, about which there has been considerable debate. The conclusion seems to be that either (1) there is no equilibrium in the sense of balance or a condition which could be maintained indefinitely, or (2) equilibrium requires the intervention of some non-economic stabilizing factor. Hicks's results, like those of Pareto, point to this conclusion. Nor does Samuelson's kinematics afford any logical resting place.[1] The theory bogs down into instability. This results from the lack of a basis in primary demand and supply schedules as the cause and determinant of objective values. Without such a basis, equilibrium becomes the point at which you are at a given moment. If you want to deal with a long time period, you have to introduce the genii of "expectation" and endow them with powers of correct divination.

No wonder, then, that general-equilibrium theory does not bring peace to the mind. One observes its devotees floundering in a maze of symbols and signs, not quite sure where they are, and making a virtue of changing from this to that.[2]

Thus the historian, while waiting for time to tell, must in the light of recent history, conclude that Heimann is essentially right when he says: "the general-equilibrium theory finds its most fruitful application to conditions under a socialist dictatorship, that institutional pattern in which alone social norms can be directly realized."[3]

[1] Cf. Samuelson, P. A., "Dynamic Process Analysis," in *A Survey of Contemporary Economics* (Ellis, ed.), 1948, and my comment thereon, *The Annals* of the Amer. Acad. of Pol. and Soc. Sci., March 1949, p. 223. Precise dynamical assumptions are not warranted when the data are so affected by *qualitative* elements and changes. See Savage, L. J., "Samuelson's *Foundations:* Its mathematics," *Jr. Pol. Econ.*, 1948.

[2] Cf. Hicks's review of Mosak and Lange, *Economica*, 1945, where he calls previously important points, and changes therein, of no appreciable importance "practically."

[3] *History of Economic Doctrines*, pp. 212–213.

CHAPTER XXXIX

A SYNTHESIS

In the light of all the foregoing construction and criticism of economic theory from the Physiocrats to J. M. Keynes, a synthesis which may be called *general-equilibrium value theory* has been attempted by the author.[1] He undertakes to carry on in the main line of development of economics as a science, free both from the extreme objectivism of English Classical price economics and from the extreme subjectivism of the Lausanne mathematical technique. In this undertaking, may be seen the results of certain suggestions in the thought of Classical economists: Malthus suggested the treatment of demand and supply as "intensities" rather than quantities of goods. Senior suggested the treatment of supply as "resistance" to production. The Austrian School developed the concept of subjective value. Marshall goes far in this direction, and part of the time suggests the use of *primary* demand and supply schedules consisting of potential buyers' subjective valuations or prices, rather than secondary schedules of "quantities-at-a-price."

Basic Assumptions. — After a searching criticism of the fundamental weaknesses found in preceding general theories, a careful distinction is made between economic value and other values, ethical, political, aesthetic, and religious, indicating how they touch and limit one another.

Also, the importance of both technological and psychological conditions is fully recognized as limiting economic theory, thus avoiding the common error of excessive idealism. Production and Consumption are treated as equal in importance.

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[1] Haney, L. H., *Value and Distribution*, New York, 1939; *Syllabus of Economic Theory with a Statement of the Premises of Economics*, New York University, Rev. ed., 1948; *Economics in a Nutshell*, 1933; "Social Point of View in Economics," *Quart. Jr. Econ.*, 1913.

Then the basic assumption is that the mature human organism exists, and expresses its life in relation to its environment through reflex urges, emotions, and reflective choices. No assumption of rationality is made.

Value Economics. — Then, following the lead of European economists, economic "value" is distinguished from "price." Throughout, the concepts of "payments made," "preferences," and "opportunity costs" are avoided as leading to the circularity of price economics.

The search for a *causal* explanation of objective economic value is simplified by distinguishing "primary" and "secondary" values, the former being marginal utility or subjective worth (a relation between one man and one good), and the latter being "subjective value" (a relation between one man and two or more goods). How these lead to buyers' bids and sellers' asking prices is demonstrated, and thus the phenomenon of objective value is explained.

Finally, Distribution as an automatic social process based on function is considered as a part of the process of economic valuation.

A General Equilibrium. — All economic values, including the value of money, are treated as interrelated, and as being determined simultaneously by a set of interrelated forces and conditions. Any change in the value of one economic quantity implies a change in the conditions affecting all, and requires a reappraisal of the equilibria of forces. Thus only, the author holds, economics may be freed of circularity — the weakness of "mutual determination" and multiple-equational procedures.

So-called "opportunity cost" is recognized only as a secondary and transitional element in individual estimates, in the last analysis depending upon the conditions (prices) which seem important *to the individual*, but which the economist must explain.

In this connection, several geometric diagrams are presented to show how the demand intensity for all producers' goods comes from the demand for (not price of) consumers' goods, and how the supply intensity of consumers' goods depends upon the supply intensities of producers' goods. And a notable attempt is made to explain the value of money in terms of demand and supply intensities related to the function of money as an instrumental or indirect good.

The author draws upon his familiarity with railway rates for a solution of the problems raised by the monopolistic-competition theorists.[1]

New Concepts of "Marginal Utility" and "Cost." — The basic point of departure for the synthesis under discussion lies in modern psychology, from which emerges a "law of economic motivation."[2] depending on the equilibrium of the organism. This enables a definite concept of economic "force," resulting in measurable economic quantities.

Accordingly, the old concept of marginal utility is freed of hedonism, and becomes a mere "desire tendency." This is a motor tendency, which represents the motivating power of objects of desire, or goods. "Negative desire tendencies" are also important, and replace the old idea of disutility as pain-cost or unpleasurable sensation. Marginal utility thus becomes a matter of equilibrium among motor tendencies of an individual.

Here comes the concept of "subjective worth" as an equilibrium between a positive and a negative desire tendency. It makes "real cost," or overcoming desires not to do things,[3] a significant concept, and is treated as essential to an explanation of the value of money and to any non-circular concept of demand and supply schedules.

Thus "demand" and "supply" become coördinate, in the sense of potential buyers' tendencies to buy and potential sellers' tendencies to sell. It is emphasized that supply must not be regarded as a "quantity-at-a-price," but as sellers' desires to sell, backed by selling power (withholding power), and will to sell.

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[1] *Value and Distribution*, Chap. VII.

[2] *Ibid.*, p. 64.

[3] *Ibid.*, pp. 240 f., 460–464.

"Distribution" as Value. — Distribution is regarded as merely a phase of value, the one which concerns the value of the services of indirect goods. All shares in distribution are interrelated, and the services of the several factors are treated as measurable in terms of power units which find expression in product units. Thus the value of shoes and the value of shoe labor are determined at the same time and demonstrated by one diagram. At the same time that manufacturers are buying labor power units sold by shoe laborers, they are selling (perhaps in anticipation) shoes.

The theory may be called a specific productivity theory, as distinguished from marginal productivity. On the demand side, all the "shares" are interrelated, the demand for the several factors being derived from the *demand* (not price) for the product. On the supply side, are the different technological conditions which affect the sellers' desire to sell the services of the factors which they possess — the laborer his labor-power, the investor his capital-power, the enterpriser his enterprise, the landowner the use of his location or accessibility.[1]

The whole problem is narrowed by such technological limitations as the nature of the product and process, the quantities of factors available, and their attitudes toward supplying (including costs).

Time and Equilibrium. — "Time" is given an important part. It functions as an element in cost or negative desires, and is related to adjustment processes. It includes time preference, waiting, uncertainty, and estimating or anticipation (interest). But no distinction between so-called long-run and short-run periods is attempted, and no "period analysis" is required. The analysis is always *now*. As time passes, the analysis is repeated — the results depending on changed conditions. Of course, the cycle theory is just part of the general theory.

And "equilibrium" thus becomes any set of values that are consistent with existing conditions affecting voluntary individual choices, both as producers and consumers. Equilibrium (not

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[1] True whether land be owned by individual or state.

"natural," "normal," or "optimum," or other question-begging concept) is thus a condition of balance among forces, which changes whenever the forces change. Complete and stable equilibrium (not "normal") becomes a condition in which (1) marginal bid and marginal asked prices are equal (equilibrium of the firm), (2) buyers' surplus and sellers' surplus are maximized (equilibrium of the industry) and (3) consumers' surplus and producers' surplus are maximized (social equilibrium).

The Social Individual. — It is emphasized throughout that the concept of a "good" is functional, depending on what it *does*. Thus property rights are significant only as affecting human motivation. The shares of Distribution exist, no matter who receives them, the only question concerning property being one of expediency (aside from any desire tendencies pointing toward freedom of choices, whether in production or consumption). The author's thought, however, frankly accepts the individual's "desire disposition" as the fundamental starting point, and proceeding from his well-known "social point of view in economics," seeks a synthesis of differences through processes of adjustment and coöperation among individuals.

Economics a Science. — Thus the author seeks a science of economics based upon the measurement of observed individual tendencies as data, and an *understanding* of statistics as reflecting human motivations. He would avoid the escape tendencies so strong in recent years: (1) the tendency to deny the possibility of relating the economic quantity to man, thus denying the applicability to economics of cause-and-effect reasoning; and (2) the tendency to deny that man is limited by material conditions, seeking to justify the denial by assuming that goods exist — particularly producers' goods.

Not the least evidence of the truth of the causal analysis suggested by the foregoing approach to economic theory, is found in the basis such analysis has provided for accurate business forecasting.

D. GENERAL ACCOUNT OF RECENT LEADING SCHOOLS

I. DEVELOPMENTS IN ECONOMIC THOUGHT IN THE PERIOD OF DECLINING PRICES AND GROWING NATIONALISM: 1874–1933

The difficulty of presenting an accurate concise account of recent and contemporaneous economic thinkers and their thought is great. They have not acquired a perspective. In some cases, even, there can be no certainty that the thought is quite complete. A hundred years hence what is here written may seem inconsequential, and the important thinkers and thoughts appear slighted. Obviously, too, such an account opens an easy door to bias. Nevertheless, certain advantages are to be gained from the attempt at a record which is more than a mere catalogue of names and dates. The younger reader or the busy man sees a reference to Hicks, Ohlin, Pareto, or Stackelberg, or he picks up a translation of some text by Wicksell, Cassel, Laveleye, or Eucken, and if he has in mind some general characterization of the background of the author's work, he is enabled to meet the book with some basis for independent judgment. It is desirable as helping one to become oriented in the world of thought around him, and to realize that all the time he is advancing in a broad stream of ideas which issues from many points of view.

The following chapters also serve to round out the foregoing discussion of various general tendencies, and, perhaps, may be thought of as capping the climax with a summary of existing schools. And the significance of national boundaries in the molding of economic thought is further emphasized.

Partly with the idea of lessening the difficulty of this part of the work, certain limits have been arbitrarily set, and should be noted in advance. Thus, in the five following chapters, no attempt has been made to cover comprehensively the field since 1933. Though it would be unreasonably artificial to draw a "dead line" through that year, and some later developments will be referred to — especially in the United States, — the discussion virtually ends with the period of readjustment following World War I. Furthermore, the field in space is not all-embracing, for little or no attention has been given to the economic thought of Russians, Dutch-, and Spanish-speaking countries. These have each produced excellent economists. It still remains true, however, that the stream of economic thought would not be different had these men not written; while no ground of continuity demands a discussion of them.

CHAPTER XL

ECONOMIC THOUGHT IN GERMANY AND AUSTRIA, FROM 1870 TO WORLD WAR II[1]

As already stated, Smith's system of economics at first had little effect on German thought, only to be rather closely followed later. Then Rau's *Lehrbuch* held the field down to about 1870; von Thünen and Hermann, two of Germany's greatest theorists, had little influence during their own lifetimes.

Scope and Sub-Division of the Science. — This sketch — for it can be no more — of the main developments in German thought following 1870 may well lap back to Roscher, whose *System* appeared in 1854, being notable for its historical tendency and breadth of view. And the first point that demands attention is the German notion of the scope and sub-division of the science. Roscher put first the *Grundlagen der Nationalökonomie*, dealing with general theory and the interrelation of economic phenomena. Then came his treatment of technical branches (such as the economics of agriculture) and of the economic activity of the state; and finally finance.[2]

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[1] One of the most valuable sources is found in *Die Entwickelung der deutschen Volkswirtschaftslehre im neunzehnten Jahrhundert* (Leipzig, 1908), especially the "Erster Teil." This work contains numerous articles by eminent scholars; published in honor of Schmoller's birthday. See also, Suranyi-Unger, *Economics in the Twentieth Century* (1931), translated from the German by Moulton; Jöhr, W. A., *Theoretische Grundlagen der Wirtschaftspolitik*, Bk. I, 1943; Honegger, *Volkswirtschaftliche Systeme der Gegenwart;* and Spann, *The History of Economics* (translated from the German by Eden and Paul, 1930). For the last quarter of the nineteenth century one may consult also Palgrave's *Dictionary;* Philippovich, *Quart. Jr. Econ.*, Jan., 1891; Taussig, *ibid.*, Oct., 1894; Cohn, *Hist. of Pol. Econ.*, Suppl. to *Ann. Amer. Acad.*, 1894; *Handwörterbuch d. Staatsw.* under the various names, manuals of Ingram, Eisenhart, etc. Cusumano's *Scuole economiche della Germania* is a valuable although older work; also Meyer, *Die neuere Nationalökonomie in ihren Hauptrichtungen* (3d ed., 1882).

[2] The titles of his volumes were:

I, *Grundlagen;* II, *Nationalökonomik des Ackerbaues;* III, *Nat. Ök. des Handels u. Gewerbfleisses;* IV, 1, *System der Finanzwissenschaft.*

Somewhat similar tendencies appeared in later works. Thus Conrad (*Grundriss*, 1900) divided the field into (1) *National-ökonomie*, dealing with laws of cause and effect in economic phenomena; (2) *Volkswirtschaftspolitik*, treating of the functions of state and society; (3) Finance; (4) Statistics. Also Adolf Wagner, after first developing a *Grundlegung* in which he defined and correlated such fundamentals as economic motives and property, distinguished theoretical national economy from the practical branches; and finance, though it is a part of the latter, was given a separate place. Indeed, Wagner comments upon the fact that there is no fundamental logical basis for any of these divisions; simple expediency warrants it.

Not unnaturally those opposed to the historical method gave historical economics a distinct and less important place. Menger (1883), for example, distinguished three branches: historical, theoretical, and practical, the last to cover state policy and such particular practical subjects as finance. Philippovich's distinction between systematic and evolutionary-historic economics (*Grundriss*, 1893) further illustrates the idea.

This relatively sharp separation between theoretical and practical or applied economics, which has been on the whole an admirable characteristic of German thought, is doubtless to be associated with the Kameralistic origin of German economics. To the state policy (*Polizei*) and finance of the Kameralists, some theoretical system such as Adam Smith's was added. Furthermore, in Germany there was a close relation between state and university, which leads to an emphasis of the practical or political aspects of the science. While this may result in a desirable realism, it has its dangerous side; for the *Polizei* or *Politik* may color the *Wissenschaft*, and the university become the tool of a state which is not the society.

As Cossa remarks,[1] however, the distinction between pure theory (science) and practice (art) must not be confused, as it has been by some writers, with the distinction between the general and the special, although very often the former distinction leads to a treatment of subjects according to the latter.

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[1] *Introduction to Political Economy*, p. 401.

The prominence given to statistics may well be observed, Conrad and others having pointed out its place as a distinct branch of economics.

In general, in these matters, German thought became not so different as formerly from that of others. German economists came to realize that the sub-divisions they made in their treatises mostly grew out of mere expediency in presentations, while the French- and English-speaking economists often added a separate treatment of finance to their general works.

The broader scope of economics as treated by most German economists, with its inclusion of juristic and ethical elements, is implied in the foregoing distinctions.

Method. — On the score of method, there was great variety and difference of opinion. One great difference lay between the advocates of induction and those who favored deduction — the historical and the anti-historical economists. Schmoller, as already observed, would have excluded purely abstract deductions, and he favored induction from history and statistics, together with deduction from the known properties of human nature. The few remaining adherents to the historical school took a more or less similar position. On the other hand, the followers of Menger believed that only through abstraction and deduction can exact laws, the goal of science, be reached. Such were Wieser, Böhm-Bawerk, Sax, Zuckerkandl, and, to a less extent, Philippovich and Schumpeter.

A tendency to get together, however, soon developed, and this may be seen in the positions of Bücher and Wagner. The latter, while not strictly a member of the Historical School, favored a considerable use of induction from history and statistics; but, dealing largely with recent phenomena, he used deduction more and history less than did Schmoller. Bücher (1893) concluded that historical methods give the laws of the evolution of peoples, but that abstract deduction is necessary in dealing with the complicated exchange economy of today. Statistics, he believed, offer some scope for induction as a complementary and controlling process.

By the turn of the century, the famous quarrel over method had almost subsided. Hasbach, an historical economist, adopted an abstract deductive procedure in treating of human wants, and Sombart's *Modern Capitalism* (1919–1927) showed a similar trend. Meanwhile, Wieser, Böhm-Bawerk, and Schumpeter showed a greater recognition of the value of history. The tendency of the deductive economists was to recognize "social control" as a sort of secondary factor in economic life, thus becoming less abstract. To this end, the thought of Windelband, Rickert, and M. Weber concerning the epistemological difference between history and theory contributed.

Various minor methodological categories existed: the mathematical (deductive), the statistical (inductive), and the juristic, the last-named method being most frequently associated with the Historical School's tendencies.

The most prominent German exponents of the mathematical method were Launhardt, whose *Mathematische Begründung der Volkswirtschaftslehre* appeared in 1885, and Auspitz and Lieben (*Untersuchungen über die Theorie des Preises*, 1889), who worked out price curves. The Swede, Cassel, had much influence. These men followed in the footsteps of Jevons or Walras. Schumpeter made large use of mathematics.

German economists were foremost in realizing the importance of statistics as a means of verifying theory and putting it on a more "positive" basis. Knapp, Lexis (d. 1914), Inama-Sternegg, G. v. Mayr (1841–1925),[1] Stieda, and Van der Borght are writers who combined economics and statistical knowledge, not to mention Wagner, who applied the statistical method to banking problems. Meitzen (*Geschichte, Theorie, und Technik der Statistik*, 1886) will always be mentioned in connection with statistics.

Jurisprudence, with its minute logical classifications and definitions, furnishes an example by which the economic thinkers of Germany have profited. So Knapp (1842–1926) treated money as a creation of the law, Neumann (*Grundlagen*, 1889) applied the method to practical problems of taxation, and many others — like Wagner and Diehl, in their several ways — showed the same influence. In fact, it was a not uncommon tendency of German writers to go to extremes in this direction, making definitions and distinctions which are perhaps useless and are certainly not used.

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[1] *Die Gesetzmässigkeit im Gesellschaftsleben*, 1887.

Value Theory. — From the standpoint of pure economic theory, the dominant note in Germany in the early years of the present century was eclecticism. Take value theory, for example. Here one finds neither the cost nor the utility theory clearly ascendant. On the whole, it may be said that the straight marginal-utility theory had few adherents, among whom the Austrians, Sax, Zuckerkandl, Philippovich, Mises, and Hayek, deserve especial mention aside from the original Austrian leaders. The marginal idea seems to have served merely to develop a neglected point, leaving the refined Classical theory, so modified as to include developments on the utility side, in the ascendant. Wagner's thought was perhaps typical.[1] Two factors, he stated, determine price: one is temporary, being the relation between demand and supply; the other is permanent, being the cost of production where perfect competition exists. Marginal utility functions in demand. And Diehl would have combined the rival theories, holding that the Classical theory gives ample place for the recognition of utility; simply, the Classicists saw in labor the great disposable factor which is both useful and limited in supply. So with the Historical School: Schmoller, while strongly subjective, did not accept marginal utility as the determinant of market value, believing that cost theories afford a simpler solution.

Others, like Dietzel, Gerlach, and Lexis, severely criticized the marginal-utility theory.[2]

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[1] See his *Theoretische Sozialökonomik*, 1907.

[2] Dietzel, in *Jahrbücher für Nationalökonomie*, 1890; *Theoretische Sozialökonomik*, 1895; Lexis, "Grenznutzen" in *Handwörterbuch der Staatswissenschaft;* Gerlach, *Über die Bedingungen wirtschaftlicher Tätigkeit.*

R. Kaulla emphasizes institutional limitations on economic value and defends considerable fixing of "just prices."[1]

This situation led some into a sort of doubting opportunism that might almost be classed as scepticism.[2] Thus Gottl, in *Der Wertgedanke, ein verhültes Dogma der Nationalökonomie* (1897), Neumann, and Diehl may be placed here. These economists were inclined to believe that there is no simple and single problem of value, but perhaps several, varying with different classes of goods.

Schools of Thought. — Some seven distinct tendencies may be distinguished in German economic thought since 1870. These are not all of equal importance and are not mutually exclusive, but to refer to them will help toward an understanding of the period.

(1) There was a group of men who followed the Classical theory, pushing its conclusions to extremes, and omitting the limitations and qualifications found in the writings of the masters — *Epigonen*, as the Germans called them. Such names as Prince-Smith, Michaelis, J. Faucher, O. Hübner, Schulze-Delitzsch, Treitschke, K. Braun, Max Wirth, O. Wolff, Böhmert, Emminghaus, and A. Meyer may by common consent be placed here. The first two were in a sense the founders of the so-called German Manchester School.[3] The *Vierteljahrsschrift für Volkswirtschaft und Kulturgeschichte* was the organ of this group.

(2) Following List, a small group was notable as standing in opposition to the preceding, and advocating protection: Hermann, Dühring, — following Carey, — and L. Stein. Later

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[1] *Theory of the Just Price: A Historical and Critical Study of the Problem of Economic Value*, 1936, Eng. trans., 1940.

[2] So classed by Diehl in his article on "Die Entwickelung der Wert und Preistheorie," in *Die Entwickelung der deutschen Volkswirtschaftslehre im 19ten Jahrhundert*, Erster Teil, II, 71.

[3] Following the successful activity of the English Anti-Corn Law League (1846), the ideas of Cobden and Bright were transplanted to Germany. Whereas in England the work of the Manchester group was essentially a practical one, in Germany the idea of free trade was given an abstract theoretical setting, and stood for extreme individualism and self-interest. The German Manchester School was undermined by List's ideas, and pulled down by the Historical School.

F. Lenz followed List and developed a strongly nationalistic theory.

(3) *The Historical School.* — This school has been made the subject of a chapter, to which the reader is referred. Schmoller was its most prominent representative, and its chief publication is known as "Schmoller's Jahrbuch" (originally *Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft im deutschen Reich*) — Spiethoff became editor — together with the *Zeitschrift für Sozial- und Wirtschafts Geschichte.* This school included not only Werner Sombart (d. 1941), F. Kleinwächter, and G. Ruhland, but also such writers as R. Eberstadt, Grabski, J. Plenge, and Stephinger.

(4) *The Subjective School.* — Most of the members of this school stand for deduction and more or less criticism of the Historical School. Needless to say, the members of the Austrian School are included, and not only Philippovich, Mises,[1] and H. Mayer, but also Wieser and Böhm-Bawerk, continued to do notable work in the first quarter of the twentieth century. Following in their footsteps have come F. A. Hayek,[2] G. Haberler, O. Morgenstern, and F. Machlup. The latter three have made places for themselves in the United States making refinements and applications of the Austrian theory. R. Strigl (d. 1944) should be mentioned as a Neo-Austrian who not only developed the theory of saving and investment, following Hayek's analysis, but took in monopolistic competition theory.[3] The Czech, K. Engliš, is important.

Here, too, come most of the mathematical economists above referred to, and Zuckerkandl, Schumpeter, Leifmann, and perhaps Dietzel. (The latter has opposed the Austrian School).

Robert Liefmann, in his *Grundsätze der Volkswirtschaftslehre* (1917–1919), developed a psychological theory which appears to represent a highly subjective idealism. He does not accept marginal utility as the sole determinant of value, but makes valuations depend upon a balance between psychic income and costs.

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[1] *Nationalökonomie*, 1940 (Eng. ed. revised and enlarged, 1949). Prof. Mises now lectures at New York University, in the United States.

[2] *The Pure Theory of Capital*, 1941. Prof. Hayek is with the London School of Economics in England.

[3] *Kapital und Produktion*, 1934; *Einfürhrung in die Grundlagen der Nationalökonomie*, 1937.

In some respects related to the Austrian School, stand a number of "Liberal" Neo-Classical type economists who oppose *Machttheorie* (authoritarianism), favor competition where it can work, and make a place for marginal utility. Here may be placed W. Röpke[1] and L. v. Wiese. And perhaps the outstanding thinker, W. Eucken, may be classed here, though he makes his own place. He accepts economic law and equilibrium value theory (criticizing Historicism), but makes them depend somewhat upon the institutional framework.

The three remaining groups were in their various ways inclined toward Socialistic reforms: —

(5) *Socialism Pure and Simple.* — The founders, Rodbertus, Lassalle, and Marx, having passed away, Bebel (1840–1913) and Liebknecht (1871–1919) may be mentioned as the later-day representatives. Samter, too, showed leanings in this direction. J. Platter accepted straight Marxianism; while R. Wilbrandt attempted to combine it with the theory of marginal utility. The outstanding Socialist authors are Karl Kautsky (1854–1938) and R. Hilferding. The works of the Russian Marxists, P. Masslow and W. Gelesnoff, have been translated and attracted considerable attention.

(6) *The Professorial Socialists*, or *Katheder Socialisten*, as they were dubbed. These stood for social reform. The *Verein für Socialpolitik*[2] was the organization which embraced most of this group, and through the *Schriften* of this union they spoke.[3]

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[1] *Die Lehre von der Wirtschaft*, Vienna, 1937; *Die Gesellschafts Krisis der Gegenwart*, Zurich, 1941.

[2] See E. Conrad, *Der Verein f. Socialpolitik u. seine Wirksamkeit*, 196.

[3] The "Professorial Socialists" (*Katheder Socialisten*) were not Socialists, properly speaking. They merely stood for an extension of the functions of the state to accomplish various measures of social reform, and not for any sweeping alteration in the fundamentals of our social order. The name was given as a term of reproach or criticism, and has been resented by some. It has been the source of considerable misunderstanding. The *Verein*, moreover, never stood for a complete unity of views; and with time new differences and points of alignment have arisen. Cf. Boese, *Der Verein für Sozialpolitik* (Munich, 1922).

The famous Eisenach assembly leading to the formation of the *Verein* was held in 1872, with the coöperation of the following notable economists: Brentano, Cohn, Conrad, Engel, Held, Hildebrand, Knapp, Knies, Meitzen, Nasse, Neumann, Roscher, von Scheel, Schönberg, Schmoller, and Wagner. The *Verein* was first led by Nasse, then by Schmoller. Held, Schäffle,[1] Schmoller, and Wagner may be named as its chief representatives.

These men came together, not as the result of Socialistic agitation, but to discuss causes of and remedies for the obvious evils that go to make up the labor problem. They believed that a greater proportion of humanity should partake of the culture and well-being of the time. They infused a considerable element of ethics. Without confusing science and art, they believed that it is the proper duty of science to observe the results of measures and to judge by rational standards.

Schmoller well summed up the beliefs of the "Socialists of the Chair" concerning the ends and methods of social reform.[2] Reform must be gradual; the state rests on existing laws, and to change these at one stroke would expose society to lawlessness. It should be based upon a reform in the character of those participating; it must not be merely external. The demands of the state must be general and equal, appearing as a just sacrifice for the common good. And, wherever possible, the state should not take directly, but should work indirectly for a different future distribution of income.[3]

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[1] Schäffle was not a member of the *Verein*, however, and held peculiar views concerning the possibilities of corporate organization.

[2] *Uber einige Grundfragen des Rechts und der Volkswirtschaft. Ein offenes Sendschreiben an Herrn Professor Dr. Heinrich von Treitschke*, 1874–1875; 2d ed., Leipzig, 1904, pp. 119 ff. One of the famous controversies in economic literature, Treitschke's article may be found in *Preuss. Jahrbücher*, 1874: "Der Sozialismus u. seine Gönner."

[3] This last result may be attained through the following activities: (1) public education; (2) factory, building, and sanitation laws to further a normal family life; (3) technical and moral encouragement to small-scale agricultural and industrial enterprise, where it is capable of competition; (4) recognition of trade unions, etc.; (5) tax legislation which falls upon property rather than labor, and tends to prevent swollen fortunes through progressive rates on income and inheritance; (6) restriction of dishonorable kinds of industry by laws controlling stock companies; (7) agrarian and real property laws to encourage the small

It was charged that by the end of the nineteenth century the economic thought of Germany had come to be so dominated by the Socialists of the Chair as to threaten its progressive and scientific development.[1] This group appears to have gained control over the chief universities and by its acceptance of rather fixed ethical and political ideals threatened to subordinate the science to the policies of the state. Whether so sweeping a charge is justified or not, there can be little doubt that on the whole German economists had so allowed their energies to be absorbed by historical, statistical, and practical work, as to retard the development of economic science.

Though Adolf Wagner (1835–1917) was one of those who united to form the *Verein*, he gradually took up a somewhat different position after 1877, holding to a more thoroughgoing advocacy of government activity for social reform. Indeed, he recognized the influence of Rodbertus and Schäffle, — chiefly the former — to whom, with von Mohl, he ascribed some mastership, and it may be said that he went farther toward adopting the principles of Socialism than any distinguished economist had yet gone. From 1878 to 1888 Wagner (and Schäffle) edited the *Tübinger Zeitschrift für die gesamte Staatswissenschaft.* He entered economics as a specialist in statistics and finance. Then, at the request of Rau's family, he undertook to revise Rau's book, but finding his views diverging more and more from that writer's, only the first part was issued in this way. His great *Lehr- und Handbuch der Politischen Oekonomie* is his chief work, and the first volume on *Grundlagen der Volkswirtschaft* (2d ed., 1879; 3d ed., 1892) contains his fundamental economic ideas. He became more and more interested in the general principles of economics, in treating which he emphasized the significance of juristic forces and the state.

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farmer; (8) a more humane application of military service; (9) a more democratically administered national bank; (10) encouragement of peasant proprietors on the state domains; (11) all possible reforms in labor contract, conditions of employment, profit-sharing, and the like.

[1] See Pohle, L., *Gegenwärtige Krisis in der deutschen Volkswirtschaftslehre* (1911).

The thought of all these "professorial socialists" is similar to the "Institutionalism" of recent American thought. In this connection, Karl Diehl is to be mentioned. In his *Theoretische Nationalökonomie* (1927), while he made room for value theory, he treated socio-legal factors as controlling. R. Stolzman's emphasis of social ethics warrants a reference in this connection.

(7) Finally, the groups which, for want of a better name, were called *Christian Socialists* are to be noted. Perhaps "religious Socialists" would be better. These men were conservative. They were idealistic. They believed that a theological basis would be best for society. Ketteler, Moufang, and Jörg belong to the Catholic branch; Todt and Stöcker to the Protestant. More recently, H. Pesch may be classed as a "Christian Socialist."[1] In the days of the German Empire, there was some tendency for the state to support these movements as an antidote for Communism.

Some Developments since 1900. — The foregoing classification sums up the situation as it existed at or shortly after 1900. Concerning developments in the first quarter of this century, it may be said (1) that the Classical economics — except as "reconstructed" by the Austrian School or a few mathematical economists — has seemed to become almost extinct; (2) that each of the other seven groupings has continued to find some adherents; (3) and that to these has been added (*a*) the nationalistic theories of Spann and Lenz, (*b*) the "general-equilibrium" or mathematico-price economics of Schumpeter and Cassel, (*c*) the monopolistic-competition theory of Stackelberg and Amonn, (*d*) the theory of location and the spatial factor of Alfred Weber, and (*e*) a valuable body of discussion concerning what may be called the philosophy of economics and the validity of economic laws. The system of economics which Fr. Oppenheimer (1864-1944) built around the idea of land reform is also to be mentioned.

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[1] *Ethik u. Volkswirtschaft, 1918; Lehrbuch der Nationalökonomie,* 5 vols., 1923-26.

No doubt under the influence of German thought tendencies while World War I was brewing, and certainly in reaction from the individualism of the Austrian School, Othmar Spann (b. 1878) undertook to revive and develop the Romantic nationalism of Fichte and Müller in his leading work, *Fundament der Volkswirtschaftslehre* (1918). He assailed the atomistic individualism of Classical economics, and proceeded in a highly idealistic and teleological fashion to attempt a system of economics which treats the nation as an organic whole, and the individual as a subordinate member. His economics deals with the means to a social end. He called his system "Universalism." He stressed the idea that the "sociological presuppositions" must be safeguarded, and that the goals or ends of life, and especially the quality thereof, must be considered. He rejected subjectivity (it is individual) and the study of individual motives, and "sets out from the extant articulated objective totality of the body economic" — whatever that may be.

Rudolf Stolzman accepts Spann's thought in part; and a group of disciples included Andreae, Baxa, Heinrich, and Seidler-Schmid. One outcome was such extreme totalitarian thought as that of Gottl-Ottlilienfeld[1] and others.[2]

Friedrich Lenz (*Aufriss der Politischen Oekonomie,* 1927) shows some similarity, in treating economics as concerned with an organic social entity. He follows List in his nationalism, the goal of economics being the nation's welfare, and the means being productive capacities.

Almost the antithesis of the foregoing, Gustav Cassel's work was published in Germany in 1918 as *Theoretische Sozialökonomik,* and had great influence. Cassel's concept of economics narrows the field to a study of prices. He would eliminate theory as to causation, motivation, and valuation, and would deal with mathematical equations, which Spann says give us no fresh knowledge and are tautological.[3] Cassel's work caused great debate. The majority of German economists do not accept his thought. Their numerous criticisms range all the way from the point of his logical inconsistency up to his neglect of social and public-control factors.

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[1] *Wirthschaftspolitik und Theorie,* Berlin, 1939; *Wirthschaft als Wissen, Tat, und Wehr,* Berlin, 1940.

[2] Fried, F., *Das Ende der Kapitalismus,* 1931; G. Feder; and Banse.

[3] On Cassel, see above, p. 602.

Between 1920 and World War II, and particularly after the crisis of 1930, came an increased interest in cycle theory and the relation of bank credit thereto. The base for this phase had been laid in 1912 by Schumpeter's *Theorie der Wirtschaftlichen Entwickelung*. This work treats bank credit as money, and considers it as capital when used in connection with "new" channels of industry. Within limits, therefore, credit creates capital. Interest and profits are considered as existing only under "dynamic" conditions. Banks charge interest only because of their liquidity preference. And interest serves to equilibrate investment and bank credit. Also, Sombart's *Der moderne Kapitalismus* (1919) treated monetary expansion as a "dynamic" factor.

Albert Hahn (b. 1889) about 1920 put forth similar ideas, going even further in treating bank credit as capital.[1] He, too, treated interest as merely equating investment and bank credit, and referred to the liquidity preference of banks. Oversaving arises, he said, and reduces effective demand. Thus the propensity to consume falls. Hahn's work, which clearly anticipated much of Keynes's thought, caused much discussion. E. Lederer[2] (1883–1939) followed Schumpeter in emphasizing credit, and argued that mechanization of industry leads to lagging wages, unemployment, and underconsumption. H. Neisser[3] developed the idea, putting underconsumption cycle theory on a monetary (credit) basis, and bringing in international conditions.

This phase is probably to be regarded as characteristic of war-born inflation and depression in Germany. Hahn has recanted. Lederer wrote "there is hardly any radical defender of that tenet [that the cycle is a purely monetary phenomenon] to be found any more."[1]

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[1] *Volkswirthschaftliche Theorie des Bankkredits*. It is to be borne in mind that Hahn, after seeing the results of German experiments along the lines he suggested, admits error and strongly attacks Keynes's doctrines.

[2] "Konjunktur und Krisen," *Grundriss der Sozialoekonomik*, IV, 1925; *Technical Progress and Unemployment*, 1938.

[3] "General Overproduction," *Jr. Pol. Econ.*, 1934.

Closely associated, is the old British controversy over "the currency principle"; that is, the question whether deposit currency created by bank loans (and investments) is a net addition to a nation's money supply, making the whole controllable by money rates. The Currency School stood for "sound money," insisting on reserves of some standard material, and convertible notes, and emphasizing the danger of overexpanding bank credit. The earlier champions of this idea were the Swedish Economist, Knut Wicksell[2] and Ludwig Mises.[3] The opposing "Banking School" considered deposit credit as an important addition to the currency, which may be controlled by money rates. Such was Hahn's earlier thought, and, to a limited extent, Schumpeter's. This led to an overemphasis of bank credit and money markets in cycle theory, as just pointed out.

Something of a swing back toward the Currency School occurred after the collapse of German finances following 1923.

Valentin F. Wagner, just before World War II, discussed all this, taking a moderate position between the two schools, but criticizing exaggerated ideas as to the power of a banking system to "create" deposit currency.[4]

Alfred Weber (b. 1868) is notable as the early developer of the theory of industrial location, emphasizing the spatial factor and its effects upon cost of production.[5] This direction has been taken by several others.[6] The application of the theory to international trade by B. Ohlin (1933) and A. Lösch (1940) has not accepted Weber's approach, but has been more akin to general-equilibrium theory.[7] This phase of economic theory has been highly abstract. It has been used by some to defend the totalitarian state.[1]

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[1] "Developments in Economic Theory," *Amer. Econ. Rev.*, 1936.

[2] *Geldzins und Güterpreise*, 1898.

[3] *Theorie des Geldes und der Umlaufsmittel*, 1912.

[4] *Geschichte der Kredittheorien: Eine Dogmenkritische Darstellung*, Vienna, 1937.

[5] *Über den Standort der Industrien*, 1909.

[6] Predöhl, Salin, Ritschl. See Niederhauser, E., *Die Standortstheorie Alfred Webers*, Switzerland, 1944.

[7] Above, p. 796, Palander has also contributed.

Economics and Philosophy. — Dating from Wilhelm Windelband's *History and Natural Science* (1894), which dealt with the problem of knowledge and truth, and Rudolf Stammler's *Economy and Law* (1896), which applied some of Kant's ideas to jurisprudence, there developed a notable tendency to inquire into the philosophical presumptions and relations of economics, and especially the epistemology.

This discussion may be thought of as growing out of the battle over the Historical School, in the sense that that school, in standing for relativity, and what *is* as opposed to what *ought* to be, raised the fundamental epistemological questions as to (1) the validity of economic laws, and (2) whether economic laws are to be positive or normative. But, while not unrelated to the old methodological controversy, since both involve the nature of economic laws, this tendency involves more fundamental problems.[2] Perhaps the problems are: first, what is the general nature and scope of economics, and its relation to other sciences? Second, is economics a science, or what is the nature and validity of "economic laws"? The first question involves broad philosophical questions, such as the relation between subject and object, and that between individual and society. The second centers in epistemology — the origin and significance of worth judgments — and leads to questions concerning normative or qualitative values and "goals" as opposed to quantitative values and "means."

The rich German literature in this general field is a contribution not to be forgotten.

Fritz Berolzheimer (1869–1920) in his *System der Rechts und Wirtschaftsphilosophie* (1904–1907) develops the idea of an interrelation between economics, ethics, and law, considered as elements in cultural development. In a somewhat similar vein,

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[1] Wiedenfeld, K., *Die Raumbeziehungen im Wirthschaften der Welt*, 1939.

[2] For the literature on this subject, see Suranyi-Unger, *Economics in the Twentieth Century*.

R. Stolzman in his *Grundzüge einer Philosophie der Volkswirtschaft* (1920) seeks unity between subject and object, and between individual and society, thus attempting a synthesis between subjectivism and objectivism, as well as between individualism and socialism. Both Berolzheimer and Stolzman show the influence of Stammler. K. Muhs argues that neither subjectivism nor objectivism is possible alone, and that economic truth is an understanding of the relation between subject and object. Spann, from a broad sociological standpoint, considers the social aggregate as an "articulated" whole, to which the "functions" of individual parts are subordinate.

Heinrich Rickert's *The Bounds of Scientific Concepts* (1902), distinguishing value from truth, carried on Windelband's work and influenced Max Weber. The work of Max Weber (1844–1920) *On the Objectivity of Sociological and Socio-Political Knowledge* (1904) did much to start the epistemological discussion. Weber stands for a "critical objectivity." He rejects the merely subjective, such as ethical and social ideals, as a basis for economic science — such concepts must be individual, and thus lack general validity. He recognizes, however, the existence both of "ideal types" arrived at by historical evolution, and also of "supra-individual ends" or values. These may have sufficiently general recognition to become objective enough to serve as scientific data. But he appears to hold that merely pragmatic (survival) values are really subjective. R. Wilbrandt shows Weber's influence, but he bases economics on activity required to avoid suffering, and, while he sees no possibility of general norms unless derived from the nature of man (which leads him toward anarchism), he says that the economist can arrive at rules for particular cases. Sombart and Voigt are others who accept much of Weber's thought. Nickel, while criticizing Weber's epistemology, would derive norms from the necessities of economic behavior.

Weber's thought has been attacked by such economists as G. Cohn, Schmoller, and Philippovich, who defend the idea of norms based either upon the reality of general culture, or the value of acts which are "useful" both to the individual and to society.

Suranyi-Unger has contributed judiciously to this discussion, as well as to that concerning the nature and place of economics.[1]

This sketch may conclude with a brief reference to Alfred Amonn (b. 1883), who has worked out a system which indicates one possible outcome of so many divergent tendencies. Amonn is notable not only as a critic, but for a sustained attempt to harmonize different theories by distinguishing different orders of economic activity.[2] (He has, accordingly, been accused by Liefmann of eclecticism.) He distinguishes (1) individual economics, which deals with exchange and value, both subjective and objective, thus retaining much of the Classical theory; (2) Political Economy, or the theory of social welfare, in which socio-legal arrangements predominate, and price supersedes value; (3) Applied Political Economy, dealing with methods of reform, etc. The second branch of his system of thought includes a differentiation between statics and dynamics.

Amonn's thought received wide recognition in Germany following World War I, since it makes place for different theories, while limiting the field for each. (For example, Spann liked his rejection of Classical theory in the field of national economy, but disliked his acceptance of it in the field of private economy. Diehl charged him with neglecting legal conditions.) A more fundamental difficulty lies in the mixing of qualitative values, (subjective ends) with quantitative values (objective means) which is apt to be connected with any attempt to segregate individual and social economics. Perhaps, too, Amonn's distinction between dynamics and statics is too much concerned with mere quantitative differences.

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[1] *Philosophie in der Volkswirtschafteslehre*, 1923–26; *Geschichte der Wirtschaftsphilosophie*, 1931.

[2] *Objekt und Grundbegriffe der theoretischen Nationalökonomie* (1911); *Grundzüge der Volkswohlstandslehre* (1926); critical articles in *Archiv für Sozialwissenschaft; Volkswirtschaftliche Grundbegriffe und Grundprobleme*, 2nd ed. Bern, 1944; *Grundzüge der Theoretischen Nationalökonomie, 1948.*

General Characteristics. — Some of the chief characteristics of German economics may be stated as follows. It has stood for much nationalism as opposed to individualism and cosmopolitanism. A careful analysis of the functions of the state is a service for which we must thank German thinkers.

To be associated with this fact, no doubt, is their progress in scientific criticism along the line of social reform. They have seen that history evidences that private property rights are neither so comprehensive nor so absolute as at first appears: the social side of property has been illuminated. Alfred Marshall well said it is true, "as German writers have well urged, that economics has a great and an increasing concern in motives connected with the collective ownership of property and the collective pursuit of important aims."[1] In general, it is true that, in Germany, socio-political questions seem to have been the dominant ones, and most of the younger men were critical as to the shortcomings of capitalism.

The foregoing facts are associated with some tendency to subordinate economics to the political ends of the state, in a way which might lead to a defense of such tendencies as "Fascism."

A broad analysis of economic motives is characteristic of German economic thought. National, moral, and ethical factors have been more often allowed for than in English economics.

The German tendency to distinguish sharply between "price" and "value" represents an important difference for the lack of which English-speaking economists have suffered. This no doubt facilitates an understanding of the difference between subjective and objective values, and it suggests the difference between "value economics" and "price economics."

These various characteristics were accompanied by the prevalence of comparative and historical studies. Under the widespread influence of the Historical School, monographs dealing with such subjects abounded. The German economist tends to take the biological or organic point of view regarding the evolution of institutions, thus avoiding the particular form of absolutism so common in English and French economics. Some, however, have shown a certain narrowness in interpreting the view of the Classical economists, reading into the works of the latter a belief in unlimited competition, freedom of trade, etc., which is not to be found there.

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[1] *Principles* (8th ed.), p. 25.

CHAPTER XLI

ECONOMIC THOUGHT IN ITALY FROM 1870 TO WORLD WAR II[1]

No better illustration of the relationship between industrial evolution and the progress of economic thought could be given than that afforded by developments in Italy. During the greater part of the seventeenth and eighteenth centuries Italy, decadent, had lost her commercial leadership and was the object of diplomatic and martial struggles among foreign powers.

The forces leading to the French Revolution were not without effect, however, and accordingly we find such relatively important names as Genovesi (1765), Galiani (1770), Beccaria (1769), Verri (1771), and Ortes (1774) coming to the front. Although all were limited by the undeveloped character of Italy's economic background, they advocated some measure of industrial freedom.

Developments to 1875. — During the greater part of the nineteenth century, however, Italy fell behind the countries leading in economic thought; for she was torn and divided, politically and industrially, while her industrial backwardness withheld both the problems and the phenomena of economic life that were apparent in more advanced states. A rather shallow optimism furnished the prevailing economic philosophy. Accordingly from 1800 down to 1870, the chief contributions consisted in some scattering studies in currency and taxation.

During this early nineteenth-century period, the names of

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[1] Suranyi-Unger, *Economics in the Twentieth Century*, Part III; Ricci, U., *Tre economisti italiani: Pantaleoni, Pareto, Loria*, 1939; Rabbeno, "Econ. in Italy," *Pol. Sci. Quart.*, VI, 439 (1891); Loria, "Econ. in Italy," *Ann. Amer. Acad.*, II, 203 (1891); Palgrave's *Dictionary;* Graziani, "Sulle relazioni fra gli studie economici in Italia e in Germania nel secolo XIX," in *Entwickelung d. deutschen Volkswirtschaftslehre*, No. XVII; Cossa, *Introduction;* Schullern-Schratenhofen, *Die theoretische Nationalökonomie Italiens in neuester Zeit* (1891).

Gioja[1] (1767–1829) and Ferrara (1810–1900) may be noted, the latter being transitional to the development which came after 1870. Indeed, from Ferrara may be dated the beginning of the modern development of economics in Italy. He wrote no comprehensive work, but was a teacher and editor, whose views — chiefly on value, money and banking, and history of economic doctrines — are largely found in introductions contributed by him to the *Biblioteca dell' economista.* He was a free trader. In general, his views on method, *government intervention,* and the nature of economic laws, were like those of Bastiat and the French optimistic school. Ferrara is notable as being (along with the German, Dühring) a follower of Henry Carey; for he accepted Carey's peculiar rent ideas, and made the American's cost-of-reproduction idea of value the center of his own scheme of distribution. Like Bastiat and Carey, Ferrara's thought is full of paradoxes.

But in 1870, Italy became united. Soon thereafter the phenomena of transport, tariffs, currency, and the like began to develop, while a single government and a united people could confront the problems which attended an evil social and financial condition. Forthwith, a more scientific study of such subjects as population and public finance made its appearance. The leaders of the new movement were Messedaglia and Luigi Cossa.

Messedaglia (1820–1901), though not a polemist, may be regarded as the central figure in the reaction against the ideas of Ferrara and the then dominant "liberal school." He had little constructive power, but was a keen analyst and a careful, accurate worker, with considerable powers as a logician and statistician. A trained physicist and mathematician, he reflected developments in the natural sciences, and stood for the introduction of more scientific methods into economics. Messedaglia's best work is found in the field of statistics, monetary problems, and public loans. He will be remembered for his modification of Malthus' statement of the law of population; for he reasoned that even as a tendency, the increase of population could not be in a geometric ratio — 2, 4, 8, 16. When the food supply falls short, the power of population to increase will be diminished and the rate of growth decreased. Thus 4 persons will tend to produce, not 8, but 6, the result being an arithmetic progression, though still a more rapid one than governs food.

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[1] Gioja wrote *Nuovo prospetto delle scienze economiche* (1815–1817). He advocated large-scale enterprise and industrial protection, and severely criticized Smith and Say.

Meanwhile, the influence of German economics, which, as will be remembered, was undergoing important developments at this same time, must be observed. Both Cossa and Nazzani studied in Germany, and the Italian reaction of 1870 was much affected by German thought.

Luigi Cossa (1831–1896) was the first modern Italian economist to win wide international recognition, and to him is due in large measure the establishment of Italian economics on a scientific basis. At the close of the nineteenth century, the greater number of the younger Italian economists had felt Cossa's influence as a teacher or writer. He is best known by his investigations in the history of economic thought (*Guida allo studio dell' economia politica*, 1876) although, like so many of his countrymen, he has done good work in the science of finance (*Primi elementi di scienza delle finanze*, 1876). His *Guida*, translated into English as an *Introduction to the Study of Political Economy*, besides showing an extensive knowledge of the economic literature of all countries, together with much critical ability, has a "theoretical part" which contains valuable suggestions concerning the scope and method of economics, and proves the writer's claim to rank as a systematizer. Cossa studied in Germany under Roscher, and in Austria under Stein, being particularly influenced by the former, whom he calls his "revered master." Yet, on the whole, he is a follower of the doctrines of the Classical School, and, while very sympathetic with historical studies, he severely criticizes the methods of the younger Historical School.

Others who helped the new movement were Nazzani, Lampertico, and Cusumano. Nazzani (1832–1904), who showed considerable critical ability, combined the doctrines of Roscher, Schäffle, and Wagner with the Classical economics, although in the main he held to the Ricardian economics as developed by Senior.[1] Cusumano[2] had studied in Berlin. Lampertico,[3] like Nazzani, was a pupil of Messedaglia's.

Naturally the influx of ideas from the German Historical School and Socialism of the Chair meant war from Ferrara and his followers, among whom were Magliani, Martello, Pareto, and Peruzzi. Ferrara opened hostilities in 1874, and here another of Messedaglia's pupils, L. Luzzatti, gained some local fame by a temperate but weighty rejoinder. This writer's statement of the case, as being typical of the new Italian movement, is worth quoting from: —

"Between the Classical economists at one extreme and the socialistic iconoclasts at the other, there is to-day a mediation in the historical or inductive school. . . . Its adherents do not admit *a priori* either harmony or contradiction of interests. They investigate the world as it is, and not as it ought to be. . . . They admit liberty as a principle. . . . They respect and uphold progress equally with liberty; and where compulsory social action, *i.e.*, the action of the state, serves to prevent conflicts which liberty promotes and to procure benefits which liberty obstructs, they accept in their economic proceedings a directive action."[4]

The new school founded the *Giornale degli economisti* in 1875 as its organ,[5] and the editors — notable among whom was Forti — spread German economic ideas. It stood for the historical approach and accepted much state intervention. Besides those already mentioned, the names of De Martiis Cognetti

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[1] *Sunto di econ. pol.*, 1873 (a textbook much used in Italy); *Saggio sulla rendita fondiaria*, 1872; *Saggi di economia politica*, 1881.

[2] *Le scuole econ. della Germania*, 1875.

[3] *Econ. dei popoli e degli stati*, 1874–1884.

[4] *Giornale degli economisti*, Sept., 1875. Cited by Rabbeno in *Pol. Sci. Quart.*, VI, 444.

[5] Discontinued 1878; reëstablished in 1886 by Zorli. He had the coöperation of Pantaleoni, Mazzola, and De Viti.

(1844–1891), C. Ferraris, R. Schiattarella, and Ricca-Salerno are to be noted.

Leading Economists, 1875–1920. — Aside from the earlier leaders such as Ferrara, Messedaglia, and L. Cossa, the most important Italian economists, as judged by work done between 1875 and 1920, appear to have been Graziani, Loria, Pantaleoni, Pareto, Rabbeno, and Ricca-Salerno. Supino[1] and Conigliani are also to be mentioned, the former having become a leading exponent of Neo-Classicism.

Ricca-Salerno (b. 1849) was a pupil of Wagner and held a somewhat eclectic position concerning method, tempering a Classical basis with a knowledge of historical criticism and an allowance for socio-ethical factors.[2] He followed Sax in financial theory,[3] applying the deductive method and the marginal-utility analysis.

Graziani and Conigliani were his pupils. Graziani (1865–1939) wrote well on machinery and wages, stock exchanges, and other subjects in applied economies.[4] He accepted the Austrian subjective theory of value,[5] but combined it with objective elements, perhaps under the influence of Marshall.[6] Especially notable are his application of the marginal-utility theory to distribution. Conigliani (d. 1901), in his work on taxation, adopted the leading ideas of Sax.[7]

Pantaleoni (d. 1924) may also be classed as an economist who was largely affected by German thought, for he showed the influence both of Wagner and of the Austrian School. His *Principii di economia pura* (1889) has been translated into English as *Principles of Pure Economics* (1898), and is one of the best-known Italian works. Pantaleoni at bottom was an adherent of the Neo-Classical School, for he not only defined economics much as Senior did, but also reconciled marginal utility and marginal cost or disutility,[1] and opposed the interest theory of Böhm-Bawerk. He made considerable use of the mathematical method. His book on the incidence of taxes was notable as an early work.[2]

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[1] *Principii di economia politica*, 1904.

[2] *Del metodo in economia politica*, 1878.

[3] *Manuale di scienza delle finanze*, 1888.

[4] *Studii sulla teoria economica delle macchine*, 1891; *Teoria delle operazioni di borsa*, 1890; *Institutzioni di scienza delle finanze*, 2d ed., 1911.

[5] *Storia critica della teoria del valore in Italia*, 1889.

[6] See *Institutzioni di economia politica*, 1904 (4th ed., 1925).

[7] *Teoria degli effetti economici delle imposte*, 1890; concerning Sax, see above, pp. 622 f.

Vilifredo Pareto[3] (d. 1923), originally a mathematician and engineer, was led by Pantaleoni into economics. Pareto was a mathematical rationalist, in many respects like Walras, and became a member of the Lausanne School. It is also to be noted that he united with Ferrara to oppose the Socialists of the Chair. An outstanding characteristic of his thought was his uncompromising insistence upon the existence of laws or uniformities in human activities.

His first treatise on political economy[4] (1896) presents a clear discussion of the determination of objective exchange value, analyzing demand and supply with precision. His proposed substitution of the term "ophelimity" for "utility," on the ground that the latter is not satisfactory for scientific use, is meritorious and well known, though not followed save by a few disciples. The idea of a definite proportion required among the factors of production in order to insure economically successful results is sometimes called Pareto's Law. Pareto's name is also associated with a law of the inequality of the distribution of wealth, based upon statistical data which show that the larger the fortune the smaller the number of those who possess it.

This great Italian economist showed remarkable development in his thought. Originally he accepted the Classical doctrines of Liberalism, merely taking in marginal utility (*ophelimity*) which he treated as a quantity of enjoyment, as appears in his *Cours*. Then he developed the tendency common in the Mathematical School to treat marginal utility merely as the basis of exchanges, or a ratio, and at the same time to minimize the theory of value. He adopted the technique of "indifference curves" dealing with relations among valuation quanta without measurement of amounts of value. This appears in his *Manuale di economia politica* (1906), in which he seems to be less convinced of the applicability of the more abstract doctrines. Finally, he showed the mechanistic trend of his thought by publishing a notable work on sociology (*Trattato di sociologia generale*, 1916), in which he recognized the limitations of reflective choices as an explanation of social life, and allowed for customs and conventions. Thus he distinguished two sets of human motives, the logical and the non-logical or emotional. His general idea throughout, however, is one of equilibrium — an equilibrium between (1) desires and (2) obstacles to desire gratification, including the wants of others. Thus he attempts to build a mechanistic theory of social equilibrium which, in its conception of human thought and action as largely non-logical, readily lends itself to a Machiavellian sort of control by the state.

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[1] He writes: "But whoever admits this, must recognize that the new doctrines of the final degree of utility are a no less unexpected than crushing demonstration of the precision, elegance, and truth of all the theorems of the orthodox and classic economists." Pantaleoni says that "we possess two works of capital importance, the study of which is indispensable to any one who would perfect himself in economics": Marshall's *Principles* and Pareto's *Cours*.

[2] *Teoria della translazione dei tributi* (1882).

[3] Ricci, U., "Pareto and Pure Economics," *Rev. of Econ. Studies*, Vol. 1. See also above, p. 786 f.

[4] *Cours d'economie politique*, 2 vols., Lausanne, 1896; has interesting discussion of rent, entrepreneur, and diminishing returns in production.

Loria (d. 1943) deserves a separate paragraph, not because of the soundness of his views, but because of a considerable originality.[1] He makes a study of real property the basis for an attack upon the present system of distribution. Following a purely economic interpretation of history, he treated morals, law, and politics not as causes, but as results, of economic conditions. Land is the cornerstone of the system. Capitalistic property is founded upon the violent suppression of free land.

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[1] See Einaudi, L., "Achille Loria" (an obituary), *Ec. Jr.*, 1946. Chief works: — *La rendita fondiaria e la sua elisione naturale*, 1879; *Analisi della proprietà capitalista*, 1889; *Studii sul valore della moneta*, 1891; *La terra ed il sistema sociale*, 1892; *Corso di economia politica*, 1910; and the following English translations *Contemporary Social Problems*, 1911; *The Economic Synthesis*, 1914; *The Economic Causes of War*, 1918; *Karl Marx*, 1920.

Thus no mere laws could remedy present evils, but only a diffusion of property. In his later writings he defended the right of each man to land, and, as a practical remedy, suggests the payment by employers of a "territorial wage" for a term of years, with the idea that at the end of the period substantial equality would exist — as in "final" or primitive society — and coöperation could be hoped for.[1] Loria appears to have overlooked the significance of bases for capitalization other than land; and few accept so rigidly economic an interpretation of human motives and history.

Various Schools. — Following the classification adopted in discussing the German schools of economic thought, one finds that all the groups are similarly manifested among the Italian economists active between 1870 and World War I. Two notable exceptions, however, are to be found: The protectionist policy had little or no hearing among Italian economists, and the more radical doctrines of Socialism had almost as little of a following down to about 1921, Labriola representing Marxism, and Leone adhering to syndicalism. More recently, A. Graziadei represented Marxian thought.

A number of the Italians mentioned may be classed as being on the whole adherents to the English Classical School, among these being Boccardo, L. Cossa, and Nazzani. Zuccarini appears to adhere to the Classical tradition. Pantaleoni was Neo-Classical and mathematical, and much the same may be said of Valenti. On the whole, the following may be classed as Neo-Classical (and Liberal, in the older sense): L. Einaudi,[2] P. Jannaccone,[3] A. Cobiati (d.), and G. Del Vecchio.

More akin to the German "Manchester School" are the *laisser-faire* individualists, Martello, Berardi, and Bertolini, whose ideas have been represented in *L'economista.* Their thought is optimistic and stands for free trade.

Within the historical group, several sub-groups may be distinguished. Some are barely touched with the historical spirit, such as Nazzani, Alessio,[1] Ricca-Salerno,[2] and perhaps Lampertico. Others resemble the older Historical School — and even Roscher, the least radical of them — among these being L. Cossa, E. Cossa,[3] and Gobbi.[4] Cusumano[5] goes further than Cossa in emphasis of historical relativity. Finally, come a few representatives of the extreme type of the younger Historical School, these being represented by such earlier economists as Schiattarella[6] and Cognetti[7] (1844–1891).

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[1] *Constituzione economica odierna,* 1900. See also *La rendita fondiaria e la sua elisione naturale,* 1879; and *Economic Foundations of Society,* London, 1899.

[2] *Gli ideali di un economista,* 1921; *Le lotte del lavoro,* 1924.

[3] *Il costo di produzione,* 1901.

It must be noted that most of these men stood for a degree of eclecticism not associated with the most typical members of the German school, and that they held fast to a larger part of the Classical English economics.

Closely connected with the Historical School is a group of sociological economists, several of whom have been much influenced by Spencer: Schiattarella, Boccardo[8] (1829–1904), Cognetti, and Rabbeno. Rabbeno (d. 1897) in his thought shows a concrete, practical turn of mind, an inductive method, and sociological tendencies. His chief works[9] (1883–1892) deal with labor, coöperation, and American protectionism.

Perhaps this is the place to refer to Benedetto Croce, the philosopher-sociologist, whose attacks on Marxian materialism and criticism of objective mathematical methods have had much influence.[1]

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[1] *Saggio sul sistema tributario in Italia*, 1883–1887; *Studii sulla teoria del valore nel cambio intorno* (1890); *Lezioni di economia politica* (1923–1924).

[2] *Del metodo in economia politica*, 1878; *Storia delle dottrine finanziarie*, 1881; *La teoria del salario* (1900).

[3] *Le forme naturale della economia sociale*, 1890; see also articles in the *Giorn. d. ec.*, 1906 and 1907.

[4] *La concorrenza estera e gli antichi economisti Italiani*, 1884; *L'economia politica negli scrittori Italiani del secole XVI–XVII*, 1889.

[5] *Dell' economia politica nel medio evo*, 1876; *La teoria del commercio dei grani in Italia*, 1877.

[6] *Del metodo in economia sociale*, 1873.

[7] *Delle attinenze tra l'economia sociale e la storia*, 1865; *Le forme primitive dell' evoluzione economica*, 1881.

[8] Boccardo succeeded Ferrara as editor of the *Biblioteca dell' economista*. He was a free trader and published his *Trattato teorico-pratico di economia politica* (1853) in the spirit of Mill. He was influenced by Spencer.

[9] *L'evoluzione del lavoro*, 1883; *La cooperazione in Inghilterra*, 1885; *La cooperazione in Italia*, 1886; *Le societa cooperative di produzione*, 1889; *Il protezionismo Americano*, 1892.

State Socialism — including many of the "Socialists of the Chair" — has C. F. Ferraris (1850–1924)[2] as its chief representative, he being one of Wagner's pupils. Cusumano, Forti, and Mortara may be classed here, and Lampertico and Luzzatti also held some of the ideas of this group.

The conflicting tendency represented by the Austrian School has been active in Italy, as would be inferred from its adoption, at least partially, by such men as Graziani,[3] Mazzola (1863–1899), R. Volta, and C. Trivero. E. Cossa,[4] Conigliani,[5] Alessio,[6] and Ricca-Salerno also adopted much of the Austrian value theory. As already indicated, Pantaleoni accepted the marginal-utility idea of value in an eclectic sort of way, but by no means followed the Austrian School in their typical conclusions concerning cost and interest. After all, it is in finance that the Austrians have made most converts in Italy.

More recently there has been some tendency to extend Böhm-Bawerk's theory to cover the various types of saving and interest rates.[7]

The doctrine of marginal utility met severe criticism, and among others Supino,[8] Loria,[9] and Rabbeno attacked it. These critics agreed that the emphasis of "marginal utility," including as it does in a single word the ideas of utility and scarcity, means little but a change in terminology, while they regarded the purely subjective tendency as one-sided and as leading to the use of standards which cannot be precise. A. Graziadei (b. 1873) is notable for a penetrating attack upon the psychology of diminishing utility, in which he develops the theory of increasing satisfaction.[1] P. E. Taviani is a more recent critic of any concept of utility which has a hedonistic content.[2]

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[1] *Materialismo storico ed economia Marxistica* (1900); *Reduzione della filosofia del diritto alla filosofia dell' economia* (1907).

[2] *Saggi di economia statistica*, 1880; *Moneta e corso forzoso*, 1879; *L'assicurazione degli operai*, 1888; *Principii di scienza bancaria*, 1892.

[3] *Storia critica della teoria del valore in Italia*, 1889; *Institutzioni di economia politica* (1904).

[4] *Le forme naturale della economia sociale*, 1890; *Primi elementi di economia agraria*, 1890.

[5] *La riforma delle leggi sui tributi locali*, 1898; *Saggi di economia politica*, 1903.

[6] *Studii sulla teoria del valore nel cambio intorno*, 1890; *Lezioni di economia politica*, 1923–1924.

[7] G. Pietranera, *La dinamica dell' interesse nell' economia capitalistica*, 1940.

[8] *Giornale degli economisti*, 1889.

[9] *Nuova antologia*, April 1, 1890

The Mathematical School, headed by Pareto, has had a strong following in Italy. E. Barone (1859–1924) succeeded Pareto and made important contributions. He has been mentioned in an earlier chapter.[3] U. Ricci (d. 1946), who succeeded Pantaleoni at Rome, developed Pareto's thought in several respects, while criticizing it for excessive abstraction.[4] Graziadei, though not accepting the indifference-curve approach, borrowed from the Lausanne School the general-equilibrium idea and made much use of mathematics. Amoroso,[5] an early student of Cournot and monopoly price, has done original work in seeking a dynamic explanation of cycles by using time lags. In this, he has been followed by F. Vinci, who sets up "models" for explaining cycle phenomena and attempts a dynamic analysis in three-dimensional form.[6] Caesari, A. Roberto Murray, Tonelli,[7] Del Veochio, and Boninsegni are other well-known Italian economists of the mathematical type. Marco Fanno and Giulio La Volpe may be classed as mathematical economists.

Starting with early statistical studies concerning the Paretian system (which he thought somewhat too abstract), Bresciani-Turroni[8] has gone on to present an outstanding analysis of saving and its relation to social equilibrium, in which he finds himself opposed to the Keynesian doctrine. He is followed by L. Frederici who criticizes the monetary macro-economics and defends the gold standard as a basis for equilibrium. Bresciani-Turroni and M. Fanno hold to the Mises-Hayek theory of business cycles. Fanno has a notable theory of the demand for and supply of money as related to the determination of interest rates.[1]

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[1] *Intorno alla legge del godimento decresente ed al principio del grado finale di utilità* (1901); *Prezzo e sovraprezzo nella economia capitalistica* (1923); *La teoria del valore ed il problema del capitale "constante"* (1926); and other works. Graziadei was a Marxian economist.

[2] *Il concetto di utilità e la teoria economica*, Milan, 1938.

[3] See above, p. 788.

[4] See articles in *Giorn. d. ec.*, 1906, 1924.

[5] "La teoria matematica del monopolio trattata geometricamenti," *Giorn. d. ec.*, 1911; *Lezioni di economia matematica*, 1921; *Principii di economica corporativa*, 1938; *Cournot nella economia e nella filosofia* (Co-author) Padua, 1939.

[6] *Analisi economiche*, Bologna, 1940.

[7] Pietri-Tonelli, *Lezioni di scienza economica razionale e sperimentale*, 1921.

[8] "Di alcune relazioni fra prezzi presenti e prezzi futuri nel marcoto dei prodotti," *Giorn, d. ec.*, 1915; "The Theory of Saving," *Economica*, 1936; *The Economics of Inflation*, 1937.

The Inter-war Period. — In the period between World War I and World War II, and especially after the crisis of 1930, there developed in Italy as in most European countries a growing interest in collectivist schemes. Communism grew, and was opposed by Fascism, or the theory of the corporate state. It is reasonably clear that most of the leading Italian economists were opposed to both. But some, and particularly those of the Mathematical School, leaned toward the "corporative economics," and some younger men adopted it wholeheartedly. Amoroso in 1938 showed how the mathematical general-equilibrium theory may serve any ends desired in a managed economy.[2] Others tried to fit business planning into nationalist plans.[3] There was some tendency to accept an economics of war, national self-sufficiency, and to attack the gold standard.[4] Still others defended "corporativism," and developed the economics of imperfect competition.[5] G. Capodaglio gives a list of those in the current of Italian "corporative economics."[6]

On the other hand, the Liberal and Neo-Classical economists, including the adherents of the Austrian School, found themselves in a difficult position. Some were driven out, as Ricci from

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[1] *Le banche il mercato monetario.*

[2] *Principii di economica corporativa*, Bologna, 1938.

[3] E.g., La Volpe, *Recerche di dinamica economica corporativa*, 1938.

[4] E.g., Russo, L. F., *Preparazione e condotta economica della guerra*, Rome, 1942.

[5] E.g., Vito, F., Fernoldi, and Tonini, *Gli aggruppamenti di imprese nell' economia corporativa*, Milan, 1939.

[6] *Sommario di storia delle dottrine economiche*, Bologna, 1937. Included are: G. Arias, G. Bottai, F. Carli, C. E. Ferri, U. Spirito, R. Benini, A. De' Stefani, M. Fanno, G. U. Papi, G. Masci, R. Bachi, M. Manoilescu. To these may be added G. Napolitano and E. Fossati.

Rome. Some were silenced, and by 1943 the leading Italian economic journals were suppressed by the totalitarian state. But some economists merely sought to limit the scope of their studies or writing so as not to conflict with the corporate state's policies. Thus they made economic theory very general, keeping it apart from ethics and politics, or treating it in its special and technical aspects.[1]

Summary. — All authorities seem agreed that the Italians have a notable tendency to eclecticism in economics. They soften and harmonize the teachings of various schools. Beginning with the Classical economics, they fell under the influence of Bastiat and Carey, and Ferrara somewhat modified the English doctrines in the direction of optimism. To this condition, came the historical tendency, led by Cossa, out of which admixture arose the dominant historico-liberalistic eclecticism of the early 1900's. Soon the Austrian subjectivism was added, with Graziani outstanding. But even the marginal-utility theorists have made some modification, approaching more closely the Classical theories, and so making a fusion with the other group less difficult. Finally, Pareto with his mathematical and rationalistic thought became a leading factor — and he turned sociologist! Throughout the whole period it is notable that in Italy, as in France, a considerable element of Liberal or Classical thought has persisted. The doctrines of Keynes appear to have little following. But, as the foregoing list of those who in varying degrees accepted "corporative economics" shows, the conditions attending World War II affected Italian economic thought. Perhaps the typical case was to recognize a "corporative economy" separate from individual (and even social) economies, and to allow the state a large amount of control to prevent irrational individual behavior. There was much discussion of "dynamic" conditions and "social welfare" in a managed economy (e.g., Fossati, *Il nuova ordine economico di F. D. Roosevelt*, 1937).

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[1] E.g., Battaglia, F., and Bertolino, A., *Problemi Metodologici nella storia delle dottrine politiche ed economiche*, 1939.

When all has been said, it remains true that well down to the close of the last century the original contributions of Italian thought to the progress of economic science had been slight. But as Italy developed industrially, the subtle work of Pareto, Graziani, and their respective followers, supplemented by the useful historical studies led by L. Cossa, have borne fruit.

CHAPTER XLII

ECONOMIC THOUGHT IN FRANCE (AND BELGIUM); FROM 1870 TO WORLD WAR II[1]

The first real economists, the Physiocrats, were Frenchmen, and to France belongs an honorable part in the founding of the science of political economy. But with the close of the eighteenth century, it will be remembered, England took the lead, and after Say, France neither produced any important works nor possessed a school of economists until about 1845, though French idealistic or Utopian Socialism flourished.

French "Traditionalism": Individualism, Optimism, Absolutism. — At length, near the middle of the nineteenth century, there arose a revival of Classicism, marked by the advent of such men as Dunoyer and Bastiat. English influence was decidedly dominant, and after 1860, when tariff barriers between England and France were largely removed, the "Manchester School" carried the day with a high hand. (The commercial agreement just alluded to was largely influenced by Cobden and the French economist and statesman, Chevalier.) Individualistic philosophy and deductive methods reigned supreme.

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[1] See Suranyi-Unger, *Economics in the Twentieth Century;* Lamontagne, "Some French Contributions to Economic Theory," *Canadian Jr. of Econ. Pol. Sci.*, 1947; Pirou, G., *Les doctrines économiques en France depuis 1870;* Gonnard, M., *Histoire des doctrines économiques*, 1946; Baudin, *Précis d'histoire des doctrines économiques*, 1947; Gide-Rist, *History of Economic Doctrines;* Antonelli, "Recent Tendencies in French Economics," *Jr. of Pol. Econ.*, XXXI (1923); Béchaux, *L'école économique français* (1902); Feilbogen, "L'évolution des idées économiques et sociales en France depuis 1870," in *Rev. d'hist. des doct. écon.*, 1910, pp. 1–41; Gide's articles on various tendencies in French economics, in *Econ. Jr.*, June, 1907, and *Pol. Sci. Quart.*, December, 1890, and *Jahrbücher* (Schmoller), 1895; De Foville, "The Economic Movement in France," *Quart. Jr. Econ.*, 1890, pp. 222–232; Bonar, "Studies in the Origin of French Economics," *Quart. Jr. Econ.*, 1890, p. 100; Palgrave's *Dictionary*.

The typical French economist was highly optimistic and absolute in his thought. This period, extending down through 1878, has been called one of traditionalism. Bastiat was its dominating spirit.

The statistical work of Quetelet was not historical, and not inconsistent with absolutism in thought.[1]

As Professor Gide has pointed out, it is well to note here that the French school of Liberalists has never been quite identical with the English in its thought. From Mercier de la Rivière to Leroy-Beaulieu, their optimism has been underlain by a belief in the beneficence of "natural law." Their optimism has concerned the future, that is, the possible future. Evils they recognize; but these arise, they believe, from failing to observe the natural law — in not leaving industry free and untrammeled.

Some reasons for this optimistic tendency have been suggested in connection with Bastiat's thought.[2] If to these reasons there be added the fact that until well into the present century the prevalence of small farms and industrial enterprises in France made individualism more natural and reasonable than elsewhere, it will be easier to understand the tenacious hold of an old school in the land of the Physiocrats.

To be sure, there were exceptions among French-writing economists; Rossi (1787–1848), Sismondi, Cherbuliez (1797–1869), and Le Play were such. But Rossi was an Italian; Sismondi and Cherbuliez were Swiss; and, if Le Play was inductive and something of a romanticist reactionary, still he does not fall in the enemy's camp.[1] The work of Cournot and Walras was rejected by the dominant school, the latter having been virtually an exile in Switzerland.

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[1] Quetelet (1796–1874) was a Belgian statistician, notable as the founder of social statistics. Primarily a mathematician and social scientist, he sought the laws of group phenomena. He considered moral as well as material data, and did not deny the freedom of the will; but he gave scant recognition to the individual, and he believed that laws of natural necessity underlie many social phenomena. His mortality tables, in which he separates urban and rural population, are notable achievements. Chief writings: *Instructions sur la probabilité*, 1828; Eng. trans., 1839; *Sur la possibilité de mésurer l'influence des causes qui modifient les éléments sociaux*, 1932 (Eng. trans., *Tracts on Mental and Moral Statistics*, Series IV, Vol. 5, London); *Sur l'homme, physique sociale*, 1835; *Lettres á S.A.R. le Duc, regnant de Saxe-Coburg et Gotha sur la théorie des probabilités*, 1846 (Eng. trans., London, 1849); *Du système sociale et des lois qui le régissent*, 1848.

[2] See above, p. 313.

Such was the situation in 1878, when a new movement became effective in France, as, in various ways, it had been working in other countries. But the French Classical economics was too much in accord with the culture and institutions of France to be cast off quickly or even be greatly changed. It continued to prevail in public affairs. The Liberalists (economic conservatives) are still found in certain universities.[2] Moreover, it reigned in the dominant *Académie des Sciences Morales et Politiques* and spoke through such journals as *Le Temps*, *Les Débats*, *Revue des deux mondes*, and the venerable *Journal des économistes*. So, too, with the *Économiste français* and the *Monde économique*. Among its adherents have been numbered Courcelle-Seneuil (1813–1892), Léon Say (1826–1896), Block, Molinari, Passy, Levasseur (1828–1911), Baudrillart (1821–

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[1] Le Play (1806–1882), in fact, was the founder of what may be called a school of thought which has been active down to recent times. He was a Catholic, and a member of the conservative school. His work lay largely in the field of sociology and social reform, the investigation of wage-earners' family budgets constituting his chief scientific activity. These investigations he made in person during the course of extended travel. Some typical conclusions were that the importance of the family as a social unit should be increased; there should be greater freedom of bequest; and the criterion of the duty of the employer should be extended beyond the mere cash nexus. His school seeks social harmony through increased moral responsibility on the part of the father in the family, the employer in the factory, and the church in the state. In 1856 Le Play founded an international society for study along the lines pursued by himself; and in France the *Union de la Paix Sociale* (Union of Social Peace), composed of local clubs for applying his methods, originated in 1872. Both have been active. It is upon these lines that Engel worked in formulating the law found in most American textbooks of economics. Le Play's chief works were: *Les ouvriers Européens. Études sur les travaux, la vie domestique et la condition morale des populations ouvrières de l'Europe, précédés d'un exposé de la méthode d'observation*, 1855; *Les ouvriers des deux mondes*, 1857–1863; *La réforme sociale en France, déduite de l'observation comparée des peuples Européens*, 1864; *L'organisation du travail* (1870: Eng. trans., Philadelphia, 1872); *Le prix social selon la pratique des autorités soumises au décalogue*, 1871; *L'organisation de la famille selon le vrai modèle signalé par l'histoire de toutes les races et de tous les temps*, 1871; *La constitution essentielle de l'humanité*, 1881.

[2] E.g., Villey at Caen, Beauregard at Paris, in the early years of the century.

1892),[1] Juglar (1819–1905), Colson, Schätz, Schelle, Stourm, Leroy-Beaulieu, Yves Guyot, De Foville, Neymarck, Cheysson (d. 1910), and Beauregard (1853–1919).

This list may be divided into two groups. One, the older individualists, may be represented by Frédéric Passy and Gustav de Molinari. Passy (1822–1912) was an idealist, and strongly emphasized property rights. He also considered ethical ideas, and is widely known for his activity in promoting international peace. Molinari (1819–1912) made individualism the keynote of his thought, but was optimistic to the verge of Utopianism. He appeared to simplify the complexities of society unduly when he virtually reduced all activities to the sway of three laws: self-interest, competition, and value. He was long the editor of the *Journal des économistes*.[2] Émile Levasseur (d. 1911) may also be classed here,[3] though his realism and the wonderful grasp of facts shown in his numerous writings, somewhat differentiate him. He was influenced by Roscher, and perhaps his best work was done in the fields of statistics and geography. He was an optimist, though his latest work showed some signs of wavering.

The younger group of individualists would include Leroy-Beaulieu (1843–1916), Yves Guyot (1843–1928), De Foville (1842–1913), Neymarck (1848–1921), G. Schelle (1845–1927), and J. Lescure (b. 1882) as its chief representatives. These men were mostly statesmen and statisticians. Though not without differences of opinion among themselves, they were all united in their hostility to Socialism, protectionism, and state intervention; but gave some recognition to recent developments in the theory of price. Guyot was the most extreme and uncompromising.[4] Leroy-Beaulieu accepted more government intervention, and showed some of the influence of the Historical School.[1] He did good work in public finance.

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[1] Baudrillart, H., *Manuel d'économie politique* (1857); *Des rapports de la morale et de l'économique politique* (1860); *Lectures choisies d'économie politique* (1884).

[2] Some of Molinari's works are: *Cours usuel d'économie politique*, 1863; *Les lois naturelles de l'économie politique*, 1887; *Notions fondamentales d'écon. pol.*, 1891; *Esquisse de l'organisation politique et économique de la société future*, 1899; *Théorie de l'évolution*, 1908.

[3] *Précis d'économie politique*, 1867 (4th ed., 1883).

[4] *La science économique*, 1881 (6th ed., 1928).

Among the important later products of the thought of this group was Colson's comprehensive *Cours d'économie politique*, the publication of which began in 1901. This work is eclectic, and in many respects resembles Marshall's Neo-Classicism. It is one of the earlier French works to expound the doctrines of the Mathematical School. M.· Colson, an engineer, is well known as the author of a valuable treatise on transportation (*Transports et tarifs*).

In addition to these earlier men, certain economists active during the first half of the present century who may be classed as "French Liberalists" are: A. Béchaux (1854–1922), L. Baudin, O. Noel (1846–1917 or 1918), C. Perreau (d.1937), M. Rouxel, E. Villey, B. Nogaro, and J. Lescure. Jean Lescure's thought shows a frank and vigorous Liberalism. He accepts the law of supply and demand, attributes capital formation to voluntary private saving, and concludes that "good money is gold money."[2] Louis Baudin, too, though giving some attention to monopoly and imperfect competition, is a strong individualist who accepts Neo-Classical value theory, defends a free gold standard, and sees "the individual, master of velocity, triumphing over the state, master of volume."[3]

There is naturally a considerable body of eclectic thought by economists who combine Classical doctrines with more modern ideas such as marginal utility. Noel,[4] Truchy,[5] Perreau,[6] and Ansiaux[7] (Belgian) are worthy of note in this connection as producers of substantial works.

The chief development in the thought of the Liberalists has been a more practical tendency. The members of the *Académie* came to defend Liberalism on other than merely *a priori* grounds, and their work became largely concrete and descriptive.

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[1] *Traité théorique et pratique d'économie politique*, 1895 (5th ed., 1910).

[2] *Étude sociale comparée des régimes de liberté et des régimes autoritaires*, 1939; "Hausses et baisses générales des prix," *Rev. d'Écon. Pol.*, 1912.

[3] *Le Mécanisme des Prix*, 1940; *La Monnaie et la Formation des Prix*, 1947; *La Monnaie*, 1938.

[4] *Principés d'economie politique et sociale* (1912–1913).

[5] *Cours d'économie politique* (1920–1921).

[6] *Cours d'économie politique* (1914).

[7] *Traité d'économie politique* (1920–1926).

Interventionism and the Historical School. — Beginning in the seventies of the last century, however, a new tendency slowly crept into French economic thought. German influence had been virtually unfelt till about this time. Then, as a result of the Franco-Prussian War (1870), more curiosity concerning German thought sprang up. Perhaps, too, the result of the war somewhat shook French optimism. Laveleye made the so-called "Socialism of the Chair" known, and M. Block wrote of German books and thought; while through the activity of Paul Gide the historical spirit of Savigny penetrated the teaching of Roman law. Charles Gide studied under Roscher.

Laveleye (1822–1892) was a Belgian writer and professor at Liège. His works deal with freedom of commerce, money and crises, rural economy and land systems, property and Socialism.[1] His views were considerably like those of the *Katheder Socialisten,* as he took the historical standpoint and denied the existence of natural laws. He will be remembered for his arguments favoring the belief in an original community of property; and, as to economic theory, for his analysis of the forces determining the productivity of labor. He was a strong advocate of international bimetalism.

The Franco-Prussian war, too, brought in its train a host of practical problems, and ultimately a veritable regeneration in politics and economics.

All this tendency would probably have been ineffectual, however, if the monopoly of economic instruction which was held by a few special schools in Paris and the Collège de France had not been broken.[2] In 1878, courses in Economics were instituted in the faculties of law of various French universities. Since few if any of the Liberalists had the training in law which was required, this meant new teachers. Moreover, it will be noted that, as teachers of law, the new men were sympathetic toward state interference, and that they were not trained in the doctrines of the French Liberalists. These new men, then, were inclined to follow the Historical School, and to advocate government intervention for social reform.

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[1] Chief writings: —
De la propriété et de ses formes primitives (1874).
Le socialisme contemporain (1881).
Éléments d'économie politique (1882).

[2] See Gide, "The Economic Schools and Teaching of Political Economy in France," *Pol. Sci. Quart.*, v. V. pp. 603–635. French economic writings have mostly come from men other than professional economists.

Accordingly, in 1879 came Cauwès' *Cours d'économie politique.* Gide published his *Principes d'économie politique* in 1883. Translations of Schmoller, Wagner, and Brentano appeared; and in 1887 the *Revue d'économie politique* was established as the organ of the new tendencies. Cauwès' notable book was nationalistic, advocating protection, and following German ideas to the extent of placing the nation and actual conditions to the fore, abandoning the procedure of reasoning from absolute universal laws. In this, List was his master.

However, the Historical School proper and its peculiar method seem to have found little favor among the French economists. In fact, Historicism as a methodology has attracted relatively little attention, although Seignobos and H. Hauser were among the few who early took up the cudgels for it; and de Greef (a Belgian), under the influence of Comte, has a sociological approach somewhat akin. It was rather to an increased study of systems other than individualism, that the new movement led, and to an acceptance of more government intervention in economic affairs.

Here the difference between the French government and that of Germany has made a difference in the thought of the two nations. The French do not look upon the state with the eyes of Germans, but regard it more as an American would. Consequently they sought some other means of obtaining the goal of the German State Socialists than that of state activity. Indeed, the great mass of the French population is middle-class, not proletarian, in its interests, and except for the laborers of the manufacturing centers, has not responded readily either to movements for extending the power of the state so as to restrict individualism greatly, or to anti-capitalistic Socialism.

As to their economics, the majority of the professors in the faculties of law, as just indicated, differ from the Liberalists. They are what C. Gide terms "interventionists." They have devoted their energies largely to the study of current problems, notably the labor problem, and have advocated government protection. The International Association for the Legal Protection of Labour (Paris, 1900) drew from their number, M. Cauwès being president of the French section. Gide mentions as adherents, Jay, Pic, Aftalion, and Bourguin, the last named being the author of *Les systemes socialistes et l'évolution économique* (1904). In this book, the author, after critically examining the various plans for solving the social problem, decides adversely to Socialism. Between 1900 and World War I, however, the chief products of the professorial group in pure theory, Landry's *L'intérêt du capital* (1904) and *Manuel économique* (1908), appear to have come through the faculty of science. (Landry, while opposed to private property in land and capital goods — and an admirer of Effertz — is essentially Neo-Classical in his economic theories. He makes contributions to the analysis of demand and supply with reference to capital, and the functioning of monopoly in fixing prices.)

Influence of Sociological Thought and "Positivism." — Although the Historical School has had relatively little following in France, and that appears to be diminishing, an effect somewhat similar to Historicism has been exerted by sociological thought. (French thinkers have been much given to formulating "systems" of social science.) There has been much analysis of the relations existing among individuals and groups, and of interrelated human motives. Thus the influence of Auguste Comte has appeared, not only in a tendency to treat economics as a "positive" science, but also to make it part of a broader sociology, and to favor considerable state intervention. Émile Durkheim is a sociologist whose thought showed these tendencies, combined with some of Spencer's ideas, and influenced

F. Simiand.[1] Simiand (d. 1935) sought to free economics from normative presumptions, and develop laws of cause and effect on an objective inductive basis, thus extending "positivism." He proposed that economics rely upon the experimental method, and put facts somewhat ahead of theories. Such ideas appear to influence R. Maunier, A. Bochard, and the sociologist, R. Worms.

The thought of Gabriel Tarde also seems to have had some effect. Tarde attempted to apply his ambitious system of philosophy and sociology[2] to economics in his *Psychologie économique* (1902). He bases economic life on an inherent "inter-psychological" bond among all men, which works through processes of adaptation and repetition. Men make adaptations to their environment, resulting in *invention.* Then *imitation* gives rise to repetition. A third element is *opposition,* which finds expression in all sorts of social conflict; but Tarde is highly optimistic, and sees higher harmony as the result.

Such is the spirit of *Solidarité.*

"Solidarity." — *Solidarité* is a term much used in France and championed by such men as C. Gide and L. Bourgeois. The distinguishing features of their plan seem to be the abolition or fundamental modification of the wages system and the emphasis given to coöperative action and various forms of voluntary association. It regards as the foundation of solidarity "those voluntary contractual associations and institutions that are created deliberately with a view to creating this feeling."[3]

Solidarité rejects the principle of competition, and so stands opposed to Liberalism. On the other hand, as accepted by most of its adherents, it differs from State Socialism in opposing the extreme length to which State Socialism goes in favoring government action, and from revolutionary Socialism in general in that it disbelieves in the efficacy of revolution or expropriation. Although considerable divergence exists among the ideas of its followers as to the part that the state should play, it virtually accepts the program of the so-called *Katheder Socialisten* as laid down by Schmoller.[1]

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[1] *La méthode positive en science économique* (1912); *Statistique et expérience,* 1922.

[2] *La logique sociale* (1895).

[3] Gide, *Principles of Pol. Econ.* (8th ed., Amer. trans.), p. 38.

Charles Gide (1847–1932), whose *Cours d'économie politique*[2] is one of the outstanding products of French scholarship, himself proceeds from a historico-sociological standpoint, and it is significant that he both studied with Roscher and was influenced by Comte.

It must be admitted that, after Walras, and while dominated by "positivism" in method, no great work in general economic theory was produced by a French economist. The Liberalists worked along Classical lines, merely adopting parts of Marshall's system without any essential addition.

Cycle Theory.[3] — French thought, however, has made important contributions to business cycle theory. As in other nations, this aspect of the economic theory became of special interest after World War I, when the importance of credit currency was emphasized and the significance of savings in connection with capital formation attracted special attention.

C. Juglar's work on *Crises* in 1860 was a pioneer in this field. The next important figure among French economists was Aftalion, who in 1911 published a work which emphasized the effect of increasing production on the desire factor in demand as the cause of business cycles. He dwelt on technical conditions as affecting the creation of capital goods, and was one of the earliest to discover the idea of "acceleration." Next came François Simiand who contributed a notable theory of long period cycles consisting in secular movements of prices apparently caused by changes in the supply of money. Simiand makes the point that the downswing which began in 1930 is of major importance because it coincides with the beginning of one of his periods of long decline.[1] Ansiaux (b. 1869; Belgian) deserves mention here for his treatment of the relation between credit inflation and crises. Writing in 1934, his thought shows the effect of the period, by going back of capital to savings. F. Divisia in 1928 further developed the idea of saving in connection with cycles and emphasized invention as a factor.[2] Others who deserve mention are Lescure,[3] Dupriez,[4] and Nogaro.[5]

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[1] For a statement and discussion of the program and ideas see Gide, *Essai d'une philosophie de la solidarité* (1902) and *Applications sociales de la solidarité* (1907). See also Bourgeois, *La solidarité* (1894), Bouglé, *Le solidarisme* (1907); Gide-Rist, *Histoire des doctrines économiques*.

[2] 1901–1907; last ed., 1915–1924.

[3] See above, Chap. XXXIV on the history of cycle theory.

A characteristic feature of much of the French cycle theory, especially in Simiand and Divisia, is the adoption of a rather rigid "positivism" which restricts the thinker to observation and induction.

Summary; Recent Trends.—Concerning the general situation in France, the following conclusions appear to be just. Among the most notable facts is the slight progress made in developing the pure economic theory until very recently. Most of the energy of French economists has been bent upon solving social problems. A concomitant fact is the tardiness with which any hearing has been given either to the Austrian School, or to the mathematico-subjective economics of Walras and Pareto.

Nor, on the other hand, has the historical method, although espoused by Laveleye, found much favor.

Well down to World War II, the dominant group of economists, strong in their caste-like control of leading societies and journals, stood for a belief in natural laws, which led them to optimistic conclusions. These "Liberalists" are the French representatives of individualism and the Classical School.

Opposed to them stood a group consisting chiefly of teachers in the law faculties who represent ideas akin to the progressive economists of Germany and the United States,—the "interventionists."

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[1] *Les Fluctuations économiques à longue période et la crise mondiale*, 1932. See Damalas, *L'Oeuvre scientifique de François Simiand*, 1943.

[2] *L'Épargne et la richesse collective*, 1928; *Cours d'Économie politique et sociale*.

[3] *Les Crises générales et périodiques de surproduction*, 5th ed., 1938.

[4] *Des Mouvements économiques généraux*, 1947.

[5] *La Crise économique dans le monde et en France*, 1936.

Between the two, a small but active group of "solidarists" has existed, seeking a remedy for social ills in perfected voluntary association. They are to be associated with a sociological approach, particularly that of Tarde.

Then there have been all varieties of Socialism, though, as elsewhere, it is not represented by any important economists. France also has her Christian Socialism — or perhaps more properly Social Christianity — with both the Catholic and Protestant branches. Indeed, this tendency has seemed to command more respect in France and Belgium than elsewhere. The system of V. Brants (a Belgian) deserves mention.

French Liberalism in economics cannot be passed over with the statement that it is a mere modification of the English Classical School. It is too diversified, too concrete or realistic, too optimistic for that. But there is still some justice in the criticism that some of the Liberalists, in a conservative and apologetic spirit, have accepted optimism — individualism, *laisser faire* — *a priori* rather than *a posteriori*. Moreover, while in French works one may find excellent studies in the history of economic thought, in the labor problem, transport, finance, and business cycles, it is true that between Bastiat's day and about 1910 relatively little was added to general or pure economic theory.

Neither the method nor the psychology of the Austrian School has appealed to most French economists. A notable exception, however, is Aftalion, who uses marginal utility in his theory of cycles and seeks a psychological approach in his treatment of money. He rejects the quantity theory, and says that the "income approach" is merely somewhat better.[1] Marginal-utility theory is also accepted by C. Rist. G. Pirou holds to an Austrian theory of value (within an institutional frame) and opposes corporativism or State Socialism[2] — as have the great majority of French economists. Recently evidence of some increase in interest in the psychology of economic motives has appeared.

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[1] *Monnaie, Prix et Change. Expériences Recéntes et Théorie*, 1940.

[2] *Introduction à l'étude de l'économie politique*, 1939.

For the most part since 1910, the thought of the Lausanne School of Walras and Pareto has received tardy recognition in France, although chiefly outside the *Académie*. The chief use made of the new doctrine was to give a mathematical form to such abstract-deductive economics as already existed. Just as the Austrian School's doctrine readily combined with English Classical economics to make the Marshallian Neo-Classicism, so the Lausanne School doctrine may be easily combined with French Liberalism. E. Antonelli in his *Principes d'économie pure* (1910) undertook a defense of Walras's system, including his doctrine of *rareté*. Others showing similar tendencies are Lenoir and Aupetit. J. Rueff[1] in his dynamic theory of monetary phenomena makes use of the Walrasian mathematical technique, and draws conservative conclusions concerning credit. A long list of recent writers, including such names as J. Moret, Bourguin, Divisia, and R. Roy, might be added to indicate a growing interest in general-equilibrium economics in France.[2] G. H. Bousquet was influenced by Pareto.[3]

With the German occupation of France during World War II, French economists were again brought into contact with the thought of other nations and since the defeat of Germany have shown indications of broadening out to a remarkable extent. (One field in which development has occurred has been imperfect-competition theory. Again it is to be noted, however, that the approach of monopolistic competition and the equilibrium of the firm fits in readily with the French tendency in economic thought.) Here come works by Divisia, Fontigny, Chamley,[4] Denis,[5] Domarchi, and Marchal.

It is notable that very few French economists have accepted the Keynesian doctrine. The general tendency is to reject it as being unduly abstract and unreal. Notable criticisms have been made by Rueff, Gide, and Mantoux.[1]

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[1] *L'ordre social*, published in Paris apparently during the early 1940's.

[2] F. Perroux, *Le Néo-marginalisme*, 1945, appears to suggest further development in this direction. He proceeds from Schumpeter's position, having translated that economist's chief work in 1935.

[3] *Cours d'économie pure*, 1928.

[4] *L'oligopole*, 1944.

[5] *Le monopole bilatéral*, 1943.

R. Mossé deals with the principles of economics under present-day collectivism of the Soviet type and appears to prefer a planned economy.[2] C. Bettelheim follows recent trends in so-called "new welfare economics" in discussing a scheme for rational calculations under central control, and seems to defend the Soviet idea of planning.[3] On the other hand, such authors as H. Laufenburger (1939) and P. Dieterlen (1946) have discussed the issue of individualism *vs.* collectivism in a moderate way, calling for compromise.[4]

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[1] See above, page 763 f. For Gide's criticism, see *History of Economic Doctrines*, pp. 738–749. See Halbwachs' review of Keynes's *General Theory*, in *Annales Sociologiques*, 1940.

[2] *L'économie collectiviste*, 1939; *Économie et legislations industrielles*, 1940.

[3] *Les problèmes théoriques et pratiques de la planification*, 1946; *La planification soviétique*, 1939.

[4] Laufenburger, H., *L'intervention de l'état en matière économique*, 1939. Dieterlen, Pierre, *Au-delà du capitalisme*, 1946.

CHAPTER XLIII

ECONOMIC THOUGHT IN ENGLAND FROM 1870 TO ABOUT 1936[1]

The more recent developments in the economic thought of England have been touched upon to some extent in preceding chapters. Thus Jevons, Marshall, and Keynes have been discussed; and the concrete-historical work of Bagehot, Leslie, Toynbee, Rogers, and Ingram has been outlined. Thornton and others, too, were mentioned in connection with the downfall of the wages-fund theory. In short, the way has been prepared for a brief *general* statement concerning the development of economics in England since 1870.

For about a generation after 1850, the Ricardian economics as restated by Mill reigned supreme in England. The tone of the system as a whole was decidedly materialistic, objective, and neglectful of ethical factors, and, needless to say, deduction was its logical weapon. It was highly individualistic. Moreover its spirit, and that of its followers, were quite absolute and dogmatic. To be unorthodox in economics was a serious reproach.

The End of Classicism. — Henry Fawcett (1833–1884) and John Elliott Cairnes (1824–1875) may be named as the leaders of the later Classicists. Fawcett did little more than present a compendium of Mill's economics. Cairnes, however, was an acute and original thinker, whose works, entitled *Some Leading Principles of Political Economy* and *Character and Logical*

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[1] Besides the works of the authors referred to, see Foxwell, "Economic Movement in England," *Quart. Jr. Econ.*, II (1887); Ashley, "The Present Position of Pol. Econ. in England," in *Die Entwickelung d. deutschen Volkswirtschaftslehre*, Erster Teil; Palgrave's *Dictionary;* Price, *Political Economy in England;* Suranyi-Unger, *Economics in the Twentieth Century*, Part IV; Scott, *The Development of Economics*, Chaps. XVIII–XIX, XXVI, XXVIII; Seligman et al. *Encyclopedia of Social Sciences.*

Method of Political Economy, have had much influence.[1] The former is notable for its portions on Value and International Trade. It is in the part on value that the author discusses *non-competing industrial groups*,[2] the theory of which will ever be associated with his name. In view of Thornton's and Jevons's attacks upon the Classicists, Cairnes restates and modifies the theory of value, emphasizing the effect of prospective supply, and defining demand as desire accompanied by purchasing power measured by the quantity offered. At this point, he severely criticizes Mill.[3]

His thought is notable for its rejection of the attempt to treat entrepreneur expenses as "costs" which can determine value. He treats cost as subjective — the sacrifices of labor, abstinence, and risk — and undertakes to show that competition, where it exists, tends to make the entrepreneur's money payments correspond to such sacrifices. It is in this connection that he develops his theory of non-competing groups.

In method, Cairnes was on the whole deductive. He held that with nothing but strict induction the economist could reason till the crack of doom and get nowhere. Like Senior, he stood for a conscious and deliberate abstraction in order to keep economics aloof from "considerations of equity and expediency." His definition of economics is typical: "the science which, accepting as ultimate facts the principles of human nature, and the physical laws of the external world, as well as the conditions, political and social, of the several communities of men, investigates the laws of the production and distribution of wealth, which result from their combined operation." Clearly, this indicates a concept of economic law that is rather exact and absolute; but the inclusion of the social and political conditions of "the several communities" is suggestive of some allowance for institutions and relativity. As compared with Ricardo, the method pursued by Cairnes was an advance, in that he did put many of his deductions to the test of facts.

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[1] Cairnes' chief works: *The Character and Logical Method of Political Economy* (1857; 2d ed., 1875); *The Slave Power* (1862); *Essays in Political Economy, Theoretical and Applied* (1873); *Some Leading Principles of Political Economy* (1874).

[2] Part I, Chap. III, § 5.

[3] Part I, Chap. IV, § 3.

Cairnes, however, is open to criticism on the score of narrowness. He hardly grasped Jevons's idea of final utility, and consequently saw no good in it. Similarly, he was inclined to state too absolutely the application of his non-competing groups.

But, in a way, Cairnes was in his day the last of the English Classicists. Forces were at work which wrought great modification in the old point of view. In the first place, came a broadening of economic analysis which arose from a recognition of the interrelation of economic and ethical factors; economics became more affected with a humanitarian interest. The labor movement was largely responsible for this development. In the same year that Cairnes died (1875), Parliament passed the Conspiracy and Protection of Property Act, and shortly thereafter the Trade Union Act of (1876), which legislation gave greater legal rights to organized labor. Toynbee was only one of many whose thought was largely colored by sympathy for labor. The attacks of Carlyle (*Past and Present*, 1843), and of Ruskin,[1] too, no doubt had their effect.

At the same time, the criticisms of the Historical School were working to give a less absolute and abstract cast to English thought. This development began notably with Leslie, who had been influenced by Sir Henry Maine and the German school. It is interesting to note that, just as in the case of France herself, England's attention was attracted to Germany and German thought as a result of that nation's success in the Franco-Prussian War (1870).

And, often associated with the historical point of view, there came a notable development in the biological sciences and the idea of evolution. The names of Spencer, Darwin, and Huxley cannot pass unmentioned here, for their philosophy and method have had no small influence upon economic concepts.

It is difficult to say just what progress has been due to the mere activity of theoretical criticism proceeding from within, as it were, and uncolored by the above developments from without. For example, it might not be easy to say how much of the downfall of the wages-fund theory was due to the activity of labor organizations, and how much due to a recognition of the inherent logical weakness of the theory. Such progress inside economic thought, however, has been exemplified in the work of Cairnes, Jevons, Marshall, and J. A. Hobson; and the theories of the American economist, F. A. Walker, had great influence in England.

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[1] E.g., *Munera Pulveris*, 1872; *Untò This Last*, 1860; *Fors Clavigera, Letters to the Workmen and Labourers of Great Britain*, 1871–1884.

All these developments involving the overthrow of "orthodoxy" came to a head in the decade 1870–1880, and, for a time, economics was a much discredited science.

It is notable that neither Cairnes nor Jevons can be said to have caused the restoration of economics in England. Cairnes accepted too much of the Classical tradition, and above all, his resort to extreme abstraction was not in accord with the practical empiricism which characterizes English thought. Jevons's brilliant thought was too critical and revolutionary — he sought to overthrow the old, and to establish at once a new system based upon marginal utility. It, too, was perhaps too obviously abstract and "theoretical" to be readily adopted in England.

Meanwhile, there had been no effective teaching of economics in the colleges and universities, — "no real working professorship of political economy in Great Britain comparable to the ordinary professorships in any German university," as Professor Ashley puts it.[1] Then Jevons made the most of a chair of political economy and logic at Owens College; a chair was founded at Edinburgh in 1871; and, above all, in 1885 the chair at Cambridge was taken by Professor Marshall, insuring effectiveness at one of the older universities and resulting in the development of the famous "Cambridge School." In 1890 the Royal Economic Society was founded, and the following year the *Economic Journal*, with Professor Edgeworth as editor, became its organ. The *Economic Review*, the organ of the Christian Social Union, was established in the same year. From this time on, the spread of economic teaching was rapid.

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[1] Just as in France, some of England's economic thought has come from without academic circles. In more recent times there are, to mention just a few, Bagehot, Booth, Rowntree, Palgrave, Webb, and Hobson.

Two economists may be mentioned as representing the transition from the old English Classicism to Neo-Classicism — Sidgwick (1838–1900) and Nicholson (1850–1927).

Henry Sidgwick's *Principles of Political Economy* was published in 1883, and undoubtedly did much to regain for economics some of the respect it had lost. The book is based upon Mill, amended by Jevons's theory, with Walker's wages theory included. It is notable, too, that the Germans, Held and Wagner, are referred to.

The careful student will ever remember that Sidgwick was primarily a philosopher, and that his chief contribution to economic thought was his system of ethics. His "rational utilitarianism," influenced by the early Scotch philosophers and Kant, rejects the empirical realism of Bentham and Mill, and sets up intuition, or an instinctive "moral sense," as the test of the good. Also, while making a place for evolution, he rejects the materialistic hedonism of Spencer's utilitarianism which is based on mere survival. This system of ethics Sidgwick applied in his economics, and it influenced the Cambridge School — especially Pigou — to take a moderately idealistic attitude toward social welfare.

In his economic theory, Sidgwick lays marked emphasis upon the theory of value and exchange. While holding that Mill's theory of value is sound in the main, he points out that "equation of supply and demand" is deficient as an explanation of exchange value when both supply and demand vary with price. The fact that cost is to some extent determined by demand is also indicated.

In connection with the theory of international values, Mill is again criticized, and originality is shown in the discussion of the importance of costs of carriage in the problem.

Sidgwick analyzes the Ricardian theory of rent into a confusion of three different ideas: (1) a historical theory of rent origins, (2) a static theory of present tendency, (3) a dynamic theory of tendency to increase in the future as population and wealth increase.[1] This point is characteristic: Sidgwick's work is subtly analytic, and his critical examination of the fundamental concepts of economics is noteworthy.

J. S. Nicholson, in his well-known *Principles of Political Economy* (1893–1901), presented a survey of economic principles based on Mill, adapting the Classical doctrines in the light of historical criticism on the one hand and of advanced mathematical analysis on the other. The treatment of relative prices, and of profits and wages, has been thought especially noteworthy. While accepting much of the Classical economics, and rejecting the mathematical tendency that came with the marginal-utility economics, Nicholson adopted the ideas of consumer's surplus and quasi-rents. In fact, both he and Sidgwick were closely related to Marshall and the Cambridge School of economic thought.

Neo-Classicism; the Cambridge School. — Without any great methodological quarrel, or any destructive revolution in economic doctrine, the Cambridge School came into existence with the advent of Alfred Marshall. This school may be briefly characterized as standing for the existence of "laws," or relatively fixed "tendencies," in economic life; its members hold that causal forces are working toward a normal equilibrium. These forces are largely capable of being summed up under the heads of supply (costs and natural scarcity) and demand (human desires and purchasing power). Their system thus centers in objective exchange value, which is partly explained by subjective factors. Cost, however, is never forgotten. The relation between value and the distribution of income is partly seen, but not fully. Competition is generally assumed, but it is to be modified and supplemented by socio-legal arrangements. Indeed, their utilitarian concept of social welfare allows considerable interference by the state. They make large use of mathematics, but, unless it be Edgeworth, their mathematics is not an essential part of the system, for they seek to *explain* value and the determination of equilibrium levels.

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[1] Book II, Chap. VII, § 1.

Alfred Marshall (d. 1924), until 1908 Professor of Political Economy at Cambridge, was admittedly the greatest English economist after Mill.[1] Indeed, there is, perhaps, no economist who surpasses him in constructive general theory. His chief works are *Economics of Industry* (1879) — with Mrs. Marshall as joint author — and *Principles of Economics*, 1890 (8th ed., 1920).

Marshall's great work was to take the English Classical economics at a time when it had fallen into considerable disrepute, and, by interpretation and modification, so to round it out and adjust it as to place it abreast of the best recent thought, and regain for it the respect of the world. An acute criticism of economic theories has a chapter headed, "The Attempt at Reconciliation; Marshall,"[2] and this is a fairly good characterization. "Marshall's synthesis" might have been better.

Being a Neo-Classicist, his most frequent logical weapon was deduction. But he sought the truth in the golden mean. He called a halt to mere historical grubbing and organic metaphors, asking for careful and rigorous reasoning, and declaring that "the growing prominence of what has been called the biological view of the science has tended to throw the notions of economic law and measurement into the background."[3] Yet he accepted the idea of relativity, and recognized the contributions of biological sciences. He rejected Comte's idea, according to which economics would be fused in a general social science, and defined economics as dealing with those motives and desires of man which can be measured by money.[4] On the other hand, he wrote: "Even for the narrower uses of economic studies, it is important to know whether the desires which prevail are such as will help to build up a strong and righteous character," [1] and he did due homage to German analysis of motives. Both induction and deduction are recognized as having their places, and Schmoller is quoted with approval. Simply, where there is still uncertainty as to causes, analysis and deduction are needed. History shows that one event follows another; but the historical method does not show the causal connection. Marshall held that enough of generality exists in certain economic characteristics to base general laws upon: that, making the usual allowance for equality in conditions, there are laws or tendencies which resemble the secondary laws of natural science. But in economics they must be handled with peculiar care.[2]

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[1] See above, Chap. XXXII.

[2] Davenport, *Value and Distribution*, Chap. XX. It is true that Marshall may be justly criticized for reading too much into the words of the old English economists.

[3] *Principles*, 4th ed., p. 72.

[4] With due limitations.

Marshall's economics, with its background of rational utilitarianism, certainly has a practical element in it; nor is it free from "preaching" and advocacy of reforms. This side, however, does not seem to warp the scientific character of the conclusions.

Marshall brought together in a masterly way the Austrian analysis and the cost concepts of his English predecessors. Utility is one side of the arch whose keystone is value, or one blade of the pair of scissors, with cost as the other. Both blades cut. They mutually determine. Thus he showed how to avoid the one-sided emphasis of either school, and treated marginal utility as the two-sided thing that it is.

In the light of developments in thought concerning differential returns, Marshall broadened the Classical theory of rent along lines already suggested by J. S. Mill. He by no means saw the necessity or expediency of abandoning a recognition of the peculiarity of land rent, but adopted the term, "*quasi-rent*," to denote those less permanent differentials which may be yielded by the superior productivity of units of capital or labor.

Marshall's contemporary, F. Y. Edgeworth (1845–1926), was for some time considered the leader of the Cambridge School after the master's death. Edgeworth made a more extreme and abstract use of mathematics than Marshall, and his work,[1] which has been translated into Italian, influenced Pareto. While he developed no general system of theory, he is well known for his studies in the determination of price under different conditions of monopoly. His method also revealed the difficulty of applying the marginal analysis to the determination of profits. He was inclined to widen the field within which monopoly may be considered socially desirable.

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[1] *Principles*, 4th ed., p. 77.

[2] *Ibid.*, pp. 93, 101.

Edgeworth's death left Professor A. C. Pigou (b. 1877) easily the outstanding economic theorist in England from 1924 to 1936. Pigou was Marshall's pupil, and succeeded him at Cambridge. While more abstract and mathematical than his predecessor, his general attitude is much the same. Yet it seems that the idea of objective value is somewhat less central in Pigou's thought than in Marshall's, and that a more idealistic concept of social welfare is more prominent.[2] He regards social welfare, however, as consisting in the sum of individual welfares, which depend upon a balance between individual satisfactions and dissatisfactions. These are psychic, but largely measurable through choices expressed in money payments. The national income (Marshall's "national dividend") is the sum of individual incomes, and represents the general welfare. This is affected, however, by the degree of equality in distribution, and Pigou goes somewhat further than Marshall in suggesting government intervention. He clearly shows the influence of Sidgwick's ethical utilitarianism.

Pigou has developed a notable theory of business cycles based upon the subjective factor of business sentiment.[3]

Other members of the Cambridge School who have followed Marshall rather closely have been Wicksteed, Flux, and Chapman. P. H. Wicksteed (1844-1927) was more subjective in his thought, and more influenced by the Austrian School. His concept of "proportional utility" contributed to a better understanding of the significance of marginal utility, and he made progress toward correlating value and distribution.[1] A. W. Flux (1867-1938) followed Marshall closely, but gave more emphasis to marginal utility.[2] S. J. Chapman presents a concise statement of Marshall's system, notable for its grasp of the nature of economics and its elementry concepts, and for a fairly consistent application of a social point of view.[3]

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[1] *Mathematical Psychics* (1881); *Papers Relating to Political Economy* (1925); "Analysis of Profit," *Jr. Pol. Econ.*, XXX, 278 (1925). See above, p. 787.

[2] *Wealth and Welfare* (1912); *The Economics of Welfare* (1920); *Essays in Applied Economics* (1923); *The Economics of Stationary States* (1935).

[3] *Industrial Fluctuations* (1927). See above, p. 679.

Others who began their work in the Cambridge School, but who have departed from it more or less widely are: H. D. Henderson, D. H. Robertson, R. F. Kahn, J. M. Keynes, R. F. Harrod, G. F. Shove, P. Sraffa, M. Dobb, and Joan Robinson — a distinguished but variegated list!

The Disintegration of the Cambridge School. — The weaknesses in Marshall's system, together with developments in the economy, soon led his pupils into lines of thought which differed from those taken by the master and from one another. Particularly after 1920 and the following years of depression, the inadequacy of Marshall's treatment of the business cycle and of money and credit became more apparent.

First came the development of "imperfect-competition" theory by such Cambridge economists as Sraffa, Shove, Harrod, and Robinson.

Partly overlapping this movement, came the development of "monetary economics" closely associated with the savings-investment approach and with the problem of business cycles. D. H. Robertson, while carrying on the Marshallian doctrine in earlier writings, developed the idea of discontinuous change and period analysis, accepting a loanable-funds theory of interest. R. F. Kahn, J. M. Keynes and his followers, such as R. F. Harrod, are other Cambridge economists who have departed from the Marshallian traditions concerning equilibrium and emphasis of "real" wealth and income.[1]

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[1] *The Common Sense of Political Economy* (1910). See above, p. 784. 1935 ed. with introd. by L. Robbins.

[2] *Economic Principles* (1904; 2d ed., 1923).

[3] *Outlines of Political Economy* (1911).

Working along with the change in economic conditions that resulted from war and depression, there is doubtless to be considered the infiltration of economic ideas from Scandinavian countries, Italy, and America. English economic theory, particularly after the first decade of the century, was fertilized by thought stemming from Wicksell, Cassell, Pareto,[2] and Fisher.

Nor is the existence within England of influences other than Marshall's school to be overlooked. The criticisms of Edwin Cannan had their effect.[3] R. G. Hawtrey was influential in developing a monetary theory of business cycles.[4] And J. R. Hicks and N. Kaldor from outside the Cambridge group have exercised outstanding influence on most phases of recent theory, including imperfect competition and the "new welfare economics."

Welfare Economics. — A tendency to modify the Classical doctrines on the score of individualism and competition has been noted. It is quite apparent in the thought of Marshall and Pigou. England's "social problem" — expanding wealth in the face of poverty-ridden masses — has been great, and was made acute by World War I. Thus the tendency of some minds to set up an ideal concept of "social welfare" as a goal, and to make economics deal with social policies directed toward such a goal, has been accentuated. This tendency we may call "welfare economics."

One of the earliest attempts to reconstruct economics on this basis was that of John A. Hobson (d. 1940).[5] Trained in the late seventies at Oxford (not Cambridge), he was influenced by Ruskin and by Toynbee. He became a social reformer, actuated by a desire to relieve "economic oppression," and seeking to make economics a sort of ethical policy.

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[1] See above, Chap. XXXVII on Keynes.

[2] There is even a "Slutsky School" in England proceeding from the thought of one of Pareto's Russian pupils, E. Slutsky. See above (787n.).

[3] Cannan's reduction of distribution to two factors, labor and property, has had subtle effects. *Review of Economic Theory*, 1930, Chap. IX.

[4] See above, p. 685.

[5] See Homan, *Contemporary Economic Thought*.

In this connection, Hobson's treatment of surplus will not be forgotten. In his *Economics of Distribution* (1900), he reasons that distribution is carried on through the fixing of market prices, accompanied by a process of bargains in which, by the superior economic strength or cunning and varying differential estimates of buyers and sellers, a "forced gain" is obtained, leaving the weaker bargainers a bare minimum inducement. "Thus emerges the true surplus value, derived not from some vague, unintelligible idea of tyranny, but from the various hindrances to perfect equality of bargaining-power in the owners of the various factors of production, and the consequent establishment of different forms and pressures of economic force."[1] According to this theory, surpluses may be found anywhere, and are not confined to rent or profits only. A conclusion is that taxes upon commodities are not necessarily borne by consumers, but may merely absorb some one of the numerous "forced gains." It may be objected that many of these so-called surpluses may be better explained as rewards for superior skill in bargaining — as differential wages, for example; and in other cases, they appear to resemble Marshall's consumers' surpluses in their origin.

Hobson's thought, which, despite numerous inconsistencies, has had much influence in America, is based upon extreme idealism. He assumes an organismic concept of society ("collective personality"), and denies the existence of "laws" based upon inter-individual exchanges. He argues that prices determine margins, — not *vice versa*. He reduces factors of production to units of productivity, either begging the question of the value of the product or ignoring the physical limitations of supply. He attributes crises to oversaving, — and, therefore, presumably underconsumption — a sure sign of question-begging economic thought.

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[1] P. 360. Hobson holds to a large part of the framework of the Neo-Classical doctrines (*Economics of Distribution*, 1900), but rejects the ideas of the beneficence of competition, and, apparently, diminishing returns. In his *Evolution of Modern Capitalism* (1901) and *The Industrial System* (1909) he shows leanings toward a sort of State Socialism in suggesting government monopoly as the alternative to the absorption of all "forced gains" by taxation. His reform schemes are developed in *The Social Problem* (1901), *Work and Wealth: a Human Valuation* (1914), *Taxation in the New State* (1920), and *Incentives in the New Industrial Order* (1923).

Other earlier "welfare economists" to be mentioned are H. Clay (*Economics*, 1916) and R. G. Hawtrey (*The Economic Problem*, 1926). They oppose individualism, consider ethics to be a necessary part of economics, and make social "welfare" the goal.

Following this early phase, the idea of "welfare economics" has come up again in the discussion of "imperfect competition" and of "general equilibrium," both of which lead to the idea of an optimum condition. Indeed, a "new welfare economics" is sometimes referred to. Here may be mentioned J. R. Hicks, L. Robbins, R. G. D. Allen, J. E. Meade, R. F. Kahn, N. Kaldor, and A. L. Bowley.[1]

The London School. — The London School of Economics,[2] which began operations in 1895, a period of depression, was founded by such Fabian Socialists as the Webbs, G. B. Shaw, and Wallas, aided by such Historical School economists as Hewins. This group was dissatisfied with the teaching of economics, and the aim was to counteract the doctrines of the Classical School, including free trade. Edwin Cannan, as an anti-Classical economist, coöperated. About 1909, the courses were expanded to include methods of relieving poverty and training for social workers. Ten years later, Sir Wm. Beveridge became director. And the early years after World War I brought in the Socialist, H. Laski.

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[1] See Myint, H., *Theories of Welfare Economics*, 1948, and bibliography; also Reder, M. W., *Studies in the Theory of Welfare Economics*, 1947. Meade's *An Introduction to Economic Analysis and Policy* (1936), and *Planning and the Price Mechanism* (1948) well represent the attempt to combine Marshallian economics with limited-competition theory.

[2] See Hayek, F. A., "The London School of Economics," *Economica*, 1946.

In 1921, the publication *Economica* was begun.

J. R. Hicks came to the School a little later. (There he worked with N. Kaldor, A. P. Lerner, and R. G. D. Allen in the years 1930–1935.) It is to be noted that the London School, while predominantly Socialist or Institutionalist in its early tendency, has been broad in its policies, and has had on its faculty such outstanding and relatively conservative economists as Hayek, Lionel Robbins, and A. A. Young.

Summary. — When one turns to the question, to what extent are the various schools or tendencies in economic thought represented in England, notable absences appear (1) in the case of that active spirit of social reform in academic circles, often somewhat misleadingly called "Socialism of the Chair," and also (2) in the case of the optimism found in France, Italy, and the United States.[1] There has been little of the examination of the philosophical presumptions of economics, although Bonar (d. 1941) and Carlile are to be noted in this field.

For the rest, the Historical School is represented by such men as Rogers, Cunningham, Ashley, Unwin, and Hewins. Edwin Cannan (1861–1935), an acute critic of economic doctrines, was a sociohistorical "realist."[2] He rejected the economics of equilibrium, and emphasized invention, discovery, and growth of population. His thought is optimistic. The Austrian or marginal-utility idea was accepted by Wicksteed and Smart (1853–1915), and is ably represented by Hayek. The Neo-Classical School has been represented by Marshall, Pigou, and some others of the Cambridge School, and by F. Benham. Wicksteed and Edgeworth were prominent exponents of the mathematical method, in which Marshall and Pigou are also adept; and to an increasing extent, as general-equilibrium economics and the use of aggregates in "macro-economic" models have grown, mathematics has been used by economists. Bowley and Yule have excelled in statistics.

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[1] The latter line of thought is to some extent represented by the statesman, Robert Giffen. Perhaps J. A. Hobson, though outside academic circles, might be classed as a representative of the former movement.

[2] *History of Theories of Production and Distribution* (1903, 2d ed.); *History of Local Rates in England* (1912, 2d ed.); *Wealth* (1914); *Money* (1926, 5th ed.); *An Economist's Protest* (1928); *Review of Economic Theory* (1930).

The various brands of Socialism all have appeared, though Marxian Socialism gained relatively little ground prior to World War I.[1] Hyndman is Marxian. So is M. Dobb. More recently, Mrs. Robinson seems to find Marxian theory somewhat more attractive than Keynes's doctrines.[2] H. D. Dickinson has worked out a so-called "competitive solution" of the problem of the optimum in a Socialist state. Tawney and Cole represent the peculiarly English "Guild Socialism." Christian Socialism, so-called,[3] — not Catholic — has had such well-known leaders as Kingsley, Ludlow, and Hughes. England is the home of that opportunist order of Socialism called Fabian, of which the Webbs, Sidney (1859–1947) and Beatrice, and Graham Wallas are the best-known representatives.

It is perhaps true that in England the question of land nationalization has been discussed with relatively great frequency. The attention given the question by Mill has been indicated, and such men as Dove and Wallace became known by their writings on this subiect.[4]

About the turn of the century, there developed in English thought a renewal of interest in the tariff question.[5] With increasingly effective competition from Germany and the United States, the question was raised as to whether England cannot protect herself by establishing preferential relations with the numerous members of the British Empire and by offsetting foreign bounties and aids by tariffs on imports of manufactures. Ashley, Cunningham, and Welsford favored "tariff reform," which meant in England a protective tariff; Smart, Pigou, Dawson, Money, and Farrer opposed it. With the postwar problems of the years from 1919 on, came a development of nationalism and a growing tendency toward restrictions on trade, of a Mercantilist nature. The discussions of this subject reached a climax about 1940 with articles by F. Benham, Kaldor, and Scitovsky.[1]

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[1] On Socialism in England, see Flint, *Socialism*, Chap. II, and supplementary note; Webb, S., *Socialism in Great Britain;* Villiers, *The Socialist Movement in England.*

[2] *An Essay on Marxian Economics*, 1942 (Rev. ed., 1947).

[3] It will be remembered that Christian Socialists are commonly not Socialists in the technical economic sense of the term. Their ideas are not generally very definite and as a rule they stand merely for reform of various particular social evils. However, there is a real Socialism which bases its doctrines on the teachings of Christ.

[4] Patrick E. Dove (1815–1873) believed in a natural right to liberty and property which should be confirmed by legislation. He was not a Socialist, nor was he revolutionary. But he favored taking taxation from labor, and placing it chiefly upon land. His views may be traced in his *Theory of Human Progression* (1850), but are elaborated in the *Elements of Political Science* (1854). A. Russell Wallace's chief work in this connection is *Land Nationalization, Its Necessity and Its Aims* (1882). He advocates common ownership with cultivation by leaseholders, the land being let to the highest bidder.

[5] Beginning about the early nineties, and reaching a climax with Joseph Chamberlain's activities from 1903 on.

In brief general characterization, it may be said that English economic thought and its development have run true to form. There has been no violent revolution. The outstanding tendency has been toward a practical concept of "equilibrium" with some relation to welfare or survival. But tendencies are not pushed to great extremes, perhaps because of a certain practical and empirical attitude. Thus Historicism becomes moderate; Socialism becomes Fabian; marginal utility is harnessed with "supply and demand." A remarkable balance between materialism and idealism underlies all this. The typical English economist is immediately concerned with objective and quantitative values, but recognizes the existence of qualitative values or goals — only the latter must seem attainable, and at least as good as existing conditions. He is loath to attack existing institutions, but this attitude involves a recognition of the importance of the institution, and any defense is based on utility. So English economics "muddles through."

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[1] See *Economica*, 1940; *Rev. of Econ. Studies*, 1942.

CHAPTER XLIV

ECONOMIC THOUGHT IN THE UNITED STATES: 1870–1946[1]

American economic thought has already been touched upon, and Franklin, Hamilton, Raymond, and Carey have been more or less fully discussed. It did not seem advisable, however, to interrupt the discussion of the general stream of thought by treating local forces and characteristics. The object of the following chapter is to set forth some of the more peculiar features of American economic theory and its development, bringing out, as it were, the local color.

The Background. — Almost from the beginning the peculiar environmental conditions met with in America have given a characteristic set of tendencies to American economics.[2]

In the first place, the point of view is generally optimistic. The country is young, and its resources are "boundless." It is far removed from the pessimism of a "stationary state," and has been, indeed, in the "advancing state" of the old Classical economists. In accordance with this general tendency, from early times to Professor Patten, there has been a correlated tendency to deny the validity of the Classical law of diminishing returns, and yet another to attack the Malthusian doctrine of population.[1] Both doctrines, as commonly understood, seemed to run counter to the facts in this new land.

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[1] Cf. Pirou, G, et al., *Les nouveaux courants de la Théorie Économique aux États-Unis*, 1939; Tugwell, *The Trend of Economics;* Suranyi-Unger, *Economics in the Twentieth Century;* Homan, *Contemporary Economic Thought*, and "Economics in the War Period," *Amer. Econ. Rev.*, 1946; Clark, J. M., "Past Accomplishments and Present Prospects of American Economics," *Amer. Econ. Rev.*, 1936, "Some Current Cleavages Among Economists," *Paper and Proc. of the Amer. Econ. Ass'n*, 1947; Scott, *The Development of Economics;* Dunbar, "The Reaction in Political Economy," *Quart. Jr. Econ.*, 1886; Fetter, "The Early History of Political Economy in the United States," *Proceedings of Amer. Philosophical Society*, Vol. 87, No. 1, 1943. Ingram, *History of Political Economy;* and the following footnote references. For works of chief American economists to 1915, see pp. 953 ff.

[2] Cf. Sherwood, *Tendencies in American Economic Thought*, Johns Hopkins University Studies, 1897; and Leslie, *Essays in Political and Moral Philosophy*, p. 126, 1880. See also Laughlin, *Jr. Pol. Econ.*, Vol. I.

Moreover, the progressive state of the country, with its attendant speculation and fluctuation in prices, may be taken partly to explain the fact that an assumed general equalization of wages and of profits is rarely made an important premise in the reasoning of American economists. The existence of wide differences in local rates of wages and profits within their nation's vast area would work toward the same result.[2]

Again, the fact that farms have been "carved out" of the wilderness before our very eyes has doubtless suggested the question, Is land not capital? Is it not "produced"? Furthermore, the abundance of land has, in connection with a democratic people, begotten a system of land ownership which has made the distinction between land and capital less obvious than it was in the home of Classical economists. Its ownership has been more mobile; its tenure and value more closely related by competition and the market. Accordingly, Carey held views at variance with those of the Classical economists on this point,[3] and recently a number of American economists have shown a strong leaning in a similar direction.

Part and parcel of the same tendency, is the further fact that Americans have been forward in applying the differential idea to labor and capital as well as land.

The scarcity of labor and capital which has existed well down to the present time has also found its expression in certain theoretical peculiarities, in addition to furthering the one just noted. For one thing, the necessity for and importance of enterprise, or the management factor, have been accentuated. Invention, too, has been stimulated, and its importance emphasized.

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[1] Carey, Thompson, E. Peshine Smith, Bowen, A. Walker, Perry. More recently this last tendency has rather shaded into a mere neglect or a minimization of the importance of the doctrine.

[2] See Leslie, *Essays in Political and Moral Philosophy*, pp. 137 f.

[3] Folwell, Amer. Econ. Assoc. Pubs., 3d annual meeting, Dec., 1888, p. 65.

This has fostered a point of view in which change and progress are regarded as normal.

But most interesting of all is the suggestion that the widespread acceptance of the marginal-productivity theory of distribution may be an offspring of a national psychology engendered by these conditions. Where labor, for example, is scarce and relatively independent, the wages-fund doctrine would hardly be suggested, while it would be easy to conceive of a relationship between productivity and income. Some of the assumptions in Professor Clark's theorizing have been actualities in America. There has been a great deal of free, no-rent land, upon which the settler put his labor. If it could be got, hired labor was paid all that it was "worth," and the subsistence wage has been far less common in America than in Europe. Labor was the factor which had to be economized, rather than land, and *its* productivity was scrutinized. The result was a productivity theory of wages; and the application of the differential idea, or perhaps an idea unconsciously caught from one of the numerous early writers who suggested the use of the marginal concept in determining value, completed the scheme. But often in the earlier days, capital was the scarcest of all, when like results might be expected in the theory of interest.

Nor is it unlikely that the readiness with which certain American theorists take to the idea of capital as a mobile fund, criticizing the idea of capital as the aggregate of capital goods, has been furthered by the prevalence of corporations and speculation and the relative mobility of investment, taken together with the preceding conditions.

Finally, America's relative isolation made her a stanch protectionist country. Located far from the old centers of arts and industry, and at a time when the products of manufacture were of great importance, the "American system," according to which ocean freight charges were to be saved and home markets developed, was a natural consequence. America, directly, and to some extent indirectly through List, has been the center of the modern protectionist idea.

In addition to these environmental factors, it is to be remembered that America was settled very largely by idealistic individuals who either clashed with their native social environments or believed that they could better their conditions by moving. A process of selection thus probably tended to establish a population containing a high percentage of idealists who were at the same time individualists of a sort. This may explain the prominence of a "volitional" psychology, which emphasizes the *will* as against either naturalism or calculation of pleasures and pains.

Of course these "tendencies" do not find equal expression in all American economists, and there have always been some who have upheld the Classical doctrines; but the most characteristic ones will always be found to illustrate the reality of them sufficiently well.

This background will afford some preparation for a brief survey of a few of the recent economic thinkers and their thought.

History.[1] — Three great periods in the history of economic thought in the United States are clearly marked.

(1) In the early days of the republic, a protectionist optimistic tendency was dominant, and the influence of a new environment appeared in a frequent opposition to the teachings of Ricardo and Malthus. Henry Carey was the most prominent and original thinker of the time. In politics the so-called "American System" was a practical expression of the dominant idea.

All the time, however, English economics formed the basis for such small teaching as there was. But Americans had little interest in Political Economy.

(2) In the second period, which embraced the generation following Civil War times, there came a rush of great economic problems, — notably the tariff and monetary matters, — a considerable growth of interest in economics, and with these, a

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[1] For a list of the chief works of economists mentioned in the following pages, see pp. 953 ff.

dominance of the English Classical theories. Francis Wayland's *Elements of Political Economy* (1837), dating from the earlier period, was much used; and the writings of Amasa Walker, John Bascom, and A. L. Perry[1] were products of this second period.

Moreover, an American translation of J. B. Say's *Traité d'économie politique* (1803) appeared in 1821, and went through many editions.[2] This work was widely used as a text before the Civil War, and even down to the eighties. It exerted a deep influence upon American economic thought.

This period may be said to reach a climax and a transition with General Francis A. Walker, son of Amasa. His work extended well into the period which followed, and he marks the beginning of a new period as well as the close of the old.

Walker's brilliant attack upon the wages-fund doctrine has already been noted, as well as his influence upon English thought. He is perhaps equally well known for his separation of the entrepreneur function, thus emphasizing it and dividing the "profits" of Smith and Ricardo into interest and entrepreneur's profits. In this, he was no doubt guided by the great development of business organization and management in America — a fact which must have been patent to him as director of the Federal censuses of 1870 and 1880. As a part of his treatment of the entrepreneur came Walker's famous theory of profits. He reasoned that profits as distinguished from interest and wages is the share of entrepreneurial ability, — an ability which is possessed by entrepreneurs in varying degrees and which in its highest forms is especially scarce. Profits, like rent, is a differential return for the superior natural advantages. There is a class of no-profit entrepreneurs, he held, just as there is no-rent land, and in so far as this is true, profits do not enter into the determination of price.[1] The price will just cover the cost of the product of the marginal or no-profits entrepreneur, including his wages. Walker argued that profits would increase with progress in civilization.

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[1] Perry's *Elements* (1866), while advocating free trade and holding to a law of diminishing returns, is more like the writings of Carey and Bastiat as to rent and the place of land as a factor.

[2] English translation by Prinsep, London, 1821, from the fourth edition of Say's work. The sixth American edition (Philadelphia, 1836) was corrected according to the fifth edition of the original, by C. C. Biddle.

With the exception of General Walker, the American economists of these earlier days were astonishingly narrow and absolute in their doctrines.[2] It was believed that almost any one could teach political economy, no special training being necessary. Amasa Walker, even, could write: "Although desirable that the instructor should be familiar with the subject himself, it is by no means indispensable." A well-arranged textbook, together with some effort on the part of the teacher and attention on the part of the pupil, would insure results.

As a result, though there was a growing interest in economic problems, the study of economics was generally regarded as dull and fruitless, if not with positive aversion. Activity was chiefly confined to the more practical and particular topics, and most of the best work appeared in periodicals. Cliffe Leslie sums up the situation as follows: —

> "Speaking generally, however, the men best qualified to stand in the front rank of American Economists are not the authors of systems or general theories, or text-books of principles, but writers on special subjects — David Wells, William M. Grosvenor, Albert S. Bolles, Francis A. Walker, Edward Atkinson, William G. Sumner, C. F. Dunbar, and Simon Newcomb. Only since the Civil War has America begun seriously to apply its mind to economic questions and the number of powerful intellects it has brought to bear on them is a remarkable phenomenon in the history of philosophy. Many of the best economic essays the last decade has produced will be found in the pages of American periodicals. . . . In the translation of Roscher and Blanqui, work has been done by America which England ought not to have left it to do. Two considerable contributions to economic history were made last year in the 'Industrial History of the United States,' and the 'Financial History of

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[1] *Political Economy* (1883), pp. 244–259. The chief criticism concerns the assumption of a no-profits margin.

[2] Francis A. Walker in 1891 wrote that American economics had been more arbitrary than even the English, *laisser faire* and assumptions based on the "economic man" being pushed to the extreme.

the United States, 1774–1789,' by Mr. Bolles. In the perfection of its economic statistics America leaves England behind." [1]

It was in this second period that one finds the first important academic recognition of economics. Professor Perry in 1865 held the title of Professor of Political Economy at Williams College; and in 1871 Professor Dunbar took a chair of Political Economy at Harvard, where Professor Bowen had been serving as Professor of Natural Religion, Moral Philosophy, and Civil Polity(!). Sumner and Walker soon took up work at Yale. Toward the end of the second period, about 1875, pressing monetary and financial problems, largely occasioned by the Civil War, aroused considerable interest in economics.

(3) About the year 1885, however, the beginning of a new era in American economic thought appeared. Among the more general grounds for the change, were great industrial developments such as the rise of railway and corporation problems, accompanied by strikes and labor agitation. The very narrowness and dogmatism of the current economics invited reaction. More particularly, there was the ferment of Henry George's propaganda, and the stimulus of Walker's bold generalizations. George's *Progress and Poverty*, with its plea for a single tax on land, appeared in 1879, and aroused such interest and provoked such debate that we of a later generation still hear its echoes, while hardly realizing its intensity. Finally, there came two thought forces from abroad: the widening ripples from the German Historical School, reinforced by Ingram's address on *The Present Position and Prospects of Political Economy* (1878), reached America in the early eighties; shortly thereafter the doctrines of the Austrian School became effective there. At about the same time, as will appear in a moment, Professor Clark was developing similar ideas.

It was in the fall of 1885 that the American Economic Association, so potent in the development of economic thought, was founded, one avowed object of its founders being to replace the abstract speculative economics of the day with a body of thought based upon historical and statistical investigation. The time was ripe for such an association. Indeed, it came hard upon the heels of an unsuccessful project, the "Society for the Study of National Economy."[1] This projected society, whose principles were formulated by E. J. James and S. N. Patten, had proposed to stand for an increase in the functions of the state, emphasizing labor legislation, railway regulation, and the conservation of natural resources; and, as illustrating the new spirit, the following statement of one of its "ends" is of interest. It was proposed: "To combat the widespread view that our economic problems will solve themselves and that our laws and institutions which at present favor individual instead of collective action, can promote the best utilization of our national resources and secure to each individual the highest development of all his faculties." The program proposed was too detailed to secure the adherence of enough economists for the organization of the society.

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[1] "Political Economy in the United States," *Fortnightly Review*, 1880; Essays, p. 154.

Those most active in originating the American Economic Association were Professors Ely, H. B. Adams,[2] E. J. James, and Seligman,[3] although some of the older economists coöperated and Francis A. Walker was made the first president. The objects of the Association were, on the whole, similar to those of the preceding society, being (1) the encouragement of economic research, (2) the publication of economic monographs, (3) the encouragement of perfect freedom in economic discussion, and (4) the establishment of a bureau of information to aid members in their studies. Its statement of principles differed in the direction of less radicalism on the score of governmental interference, and less emphasis of historical and statistical methods. These principles were the result of a conservative modification of a draft prepared by Professor R. T. Ely. They ran as follows: —

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[1] For a more complete account of the origin and work of the American Economic Association, see Ely, *Amer. Econ. Assoc. Quart.*, XI, pp. 46 ff.

[2] H. B. Adams was an historian, but his influence and encouragement was a valuable aid to the formation of the Association. The American Historical Association had been formed in 1884.

[3] At the first meeting called to discuss the formation the following among others were present: C. K. Adams, H. B. Adams, H. C. Adams, E. B. Andrews, E. W. Bemis, C. Bowen, J. B. Clark, Miss Katherine Coman, V. B. Denslow, D. R. Dewey, S. W. Dike, R. T. Ely, Washington Gladden, E. J. James, Alexander Johnston, F. B. Sanborn, Eugene Schuyler, E. R. A. Seligman, Herbert Tuttle.

> "1. We regard the State as an agency whose positive assistance is one of the indispensable conditions of human progress.
>
> "2. We believe that political economy as a science is still in an early stage of its development. While we appreciate the work of former economists, we look not so much to speculation as to the historical and statistical study of actual conditions of economic life for the satisfactory accomplishment of that development.
>
> "3. We hold that the conflict of labor and capital has brought into prominence a vast number of social problems, whose solution requires the united efforts, each in its own sphere, of the church, of the state, and of science.
>
> "4. In the study of the industrial and commercial policy of governments we take no partisan attitude. We believe in a progressive development of economic conditions, which must be met by a corresponding development of legislative policy."

It is to be observed that this statement of principles was not regarded as a creed. It was apparently never signed. Yet even so, it was the object of criticism, and was in 1888 unanimously abolished because all felt that it had done its work. Its function was to serve as a rallying point for those economists who were the progressives of the time, thus insuring a certain likemindedness in membership and leadership, desirable under such circumstances.

Indeed, ample evidence exists that the above principles were hailed by not a few with no small enthusiasm. As already noted, the period was one of transition in social thought and in economic phenomena. In the face of such great questions as the growing labor problem, railway discrimination, and monetary difficulties, all accentuated by the crises of 1873 and 1884, the old policy of *laisser faire* was proving inadequate, and the wave of nationalism which came with the Civil War no doubt made the decline of that policy easier.[1] At the same time the narrow abstractions of the economics then taught grew more and more irksome.

This is the point at which reference should be made to German influence. The men who founded the Association had studied in Germany, and had been deeply affected by the breadth and catholicity of economic studies there. In addition to those mentioned in connection with the origin of the Association, John B. Clark and Henry C. Adams were among the early active members who had studied in Germany. All these men felt the lack of freedom in American economic thought. More concretely, the idea of relativity was grasped, and at the same time the economic significance of ethical and political forces was realized. Thus, while the American Economic Association was of domestic origin and stood for American ideas, it is to be gratefully acknowledged that certain good elements in the German thought of that time were instrumental in hastening its birth and shaping its development. No doubt, too, the *Verein für Socialpolitik*[2] served to some extent as a model.

The Association at once became the center of new thought forces, gathering them together and giving them strength through the mutual support and interchange of ideas which it encouraged. It also served to stimulate further development. Its early monographs set forth ideas which later developed into well-rounded theories expounded in books, — e.g., Clark's *Capital and Its Earning* in Volume III. That a considerable part of these monographs illustrates the historical idea is natural. Nor is the practical influence of the Association to be overlooked. It has been a real force, through its membership and the reports of its committees, for improving the Federal census, and the regulation of monetary matters, the "trusts," and the railways.

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[2] See above, pp. 820 f.

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As further evidence of contemporaneous development in the world of economic thought, it is only necessary to recall that in 1886 the *Political Science Quarterly* (Columbia) and the *Quarterly Journal of Economics* (Harvard) were established, followed in 1890 by the *Annals of the American Academy of Political and Social Science* (Pennsylvania) and the *Journal of Political Economy* (Chicago), and by the *Yale Review* (Yale) in 1892. Clark's *Philosophy of Wealth* appeared in 1885, Laughlin's *Elements of Political Economy* in 1887, and Ely's *Introduction to Political Economy* in 1889.

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[2] See above, pp. 820 f.

At about this time, General Walker spoke of an intense interest in industrial conditions and in economics. And he was inclined to complain of a spirit of radicalism, a contempt for authority, and a dissatisfaction with the existing order.[1] From then on down to the present day, an eager, restless inquiry, and an extension of general and technical instruction along economic lines, have prevailed in the United States, and are the subject of frequent comment by foreign economists.

Conditions at the Beginning of the Twentieth Century.[2] — Perhaps to some extent on account of the comprehensiveness and great influence of the American Economic Association, no such division into important schools existed prior to 1920 as, for instance, was the case in Germany. Or the fact may be due in part to the later development of activity in economic thought. Coming after the reaction against the extremes of the Historical School had set in, there was less occasion for the "schools" involved. Moreover, the absence of so widespread and acute a condition of class antagonism and the evils accompanying it may explain in part the slight importance of Socialism down to 1921. It was characteristic of American economics at the end of the nineteenth century that relatively little difference of opinion was found as to the tariff and government control in general, neither being entirely condemned.

On the whole, there were but two great groups, with so many variations within both, and so shading into one another, that they cannot be called schools. One held to a large part of the teaching of Mill; the other followed the Austrian School or Professor Clark. Within the latter, a smaller third group had Professor S. N. Patten as its center. This was sometimes called the Pennsylvania group.

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[1] Amer. Econ. Assoc. Pubs., 1891. For a statement and criticism of the situation which deserves to become a classic, see Dunbar's article on "The Reaction in Political Economy," *Quart. Jr. Econ.*, I, 1–27, 1886.

[2] Much of what is here written will apply to the decades 1900–1920.

Accordingly, one finds, on the surface at least, wide difference in the importance attributed to cost in value determination, in the theory of interest, and in the treatment of land and the return from land.[1] To mention but a few names: Professors J. B. Clark, Fetter, Fisher, and Patten emphasized the subjective point of view and the utility side of marginal utility, and criticized the Classical rent doctrine; Professors Bullock, Carver, Ely, Hollander, Laughlin, and Taussig laid more emphasis upon the objective side and upon costs, and held to an enlightened Ricardian doctrine of rent.

Professor Fisher of Yale was the leading exponent of the mathematical method. Other mathematical economists were H. L. Moore (b. 1869) and H. Schultz (1893–1938).

There can be no doubt of a strong tendency among American economists to emphasize psychological analysis. After 1885 the thought of Jevons and the Austrian School took firm hold, and American economics came to the place of prominence which it had acquired by 1915 largely through independent development of parts of this field. Accordingly, it is probable that four of the six leading theorists in 1915 were Clark, Patten, Fisher, and Fetter, whose thought may be briefly examined as typical of the most striking characteristic of American economics.

J. B. Clark. — Many hold that Professor John Bates Clark (1847–1938) was the greatest constructive general theorist that America has yet produced. His claim to some originality in developing the significance of marginal utility is strong, and his name will ever be associated with the marginal-productivity analysis in static distribution. His calm, clear analysis was very suggestive, and did much to clarify distribution problems.

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[1] Cf. "The Relation between Rent and Interest," in Amer. Econ. Assoc. Pubs. new series, Vol. V, 1904; a discussion among various economists.

It is interesting to speculate upon some of the influences that must have helped stimulate and mold the thought of one who is, perhaps, America's most notable economic theorist. Professor Clark's thought shows some similarities to that of Bastiat, and it is not unlikely that in his early days he was somewhat influenced by the latter. He himself refers to the influence of a suggestion received from Henry George.[1] As a pupil of Knies, too, he no doubt drew upon that acute thinker. For the rest he accepted the idea current among economists of the historico-sociological type, that society is an organism. Add to this background Professor Clark's great power of sustained abstract speculation, and some of the chief factors in his work are apparent.

In his *Philosophy of Wealth* (1885) the two main ideas are (1) that the prevalent theory of value misconceived the part played by utility, and (2) that society is an organism to be treated as a unit in discussing processes of wealth distribution. Clark distinguishes absolute from "effective utility," defining the latter as "power to modify our subjective condition, under actual circumstances, and . . . mentally measured by supposing something which we possess to be annihilated, or something which we lack to be attained." [2] Market value is measured by this utility, estimated by society considered as a distinct organism.

Clark also emphasizes the limits set to competition in modern society, assigning a large part to non-competitive economics. An ethical purpose is very prominent: a just distribution of wealth is contrasted with the existing conditions; an appeal is made for a more rational means of effecting distribution; and the higher ethical forms of wealth are emphasized.

It is by his *Distribution of Wealth*, published in 1899, that Clark is best known. Put in a nutshell, it is the idea of the book that in a "static" condition the factors of production receive shares corresponding to the productivity of their final or marginal increments; the process being "controlled by a natural law."

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[1] *Distribution of Wealth*, Preface, p. viii. George's idea is that wages are fixed by the product which a man can create by tilling no-rent land. Clark, of course, was far from accepting George's single-tax ideas.

[2] P. 78. Compare *Distribution of Wealth*, p. 376. This statement is subject to the same criticism as was Menger's. See above, pp. 611, 614 f.

The social point of view being taken, and society being regarded as an organism, it follows that distribution and exchange, with value, are included in the round of production. Distribution has three stages; the division of social income, first among various groups of industries, then among sub-groups, and finally among the factors of production within the sub-group. The first two processes are controlled by the market price of the produce; the last — or functional distribution, as we would say — is governed by productivity, labor tending to get what it separately produces, and capital likewise.[1]

In order to reduce all units to homogeneity, Clark would fund all the factors of production. Land and capital are reduced to an abstract mobile capital fund ("social capital"), and labor to productivity units ("social labor"). Then the specific product of a unit of any factor may be segregated, he maintains, by turning to the margin. In the case of labor this margin may be found widespread in a zone of indifference as to employing more men. In all industries there is an intensive margin. It is a chief service of Clark's to have developed and defined (not originated) the idea of a fund of productive wealth, abstract and not lost in the capital goods through which it finds expression at any given time. This is similar to the business usage. It is a concept which helps to an understanding of the mobility of capital under competitive conditions.

Though, for the most part, a "natural" tendency to equalize returns in different industries is posited as the force assuring the productivity correlation, it is made clear that it is the free competition among employers that is assumed in the static state which insures the full value of his product to the laborer. The pleasure-and-pain calculus is the mainspring of the whole machine.

[1] Chap. II.

Both wages and interest can be "translated" into the form of rents on concrete producers' goods, and these rents are to be considered as elements in determining values. Clark denies peculiar significance to land rent, and such rent plays an almost inappreciable part in his system.

Professor Clark's theories did not remain unquestioned.[1] Relatively few were in agreement as to the organic character of society, and some believed that such abstraction as characterizes his theory is hardly fruitful. His "static state" is after all quite similar to one in which the "natural" conditions thought of by the Classical economists exist. Hobson and others attacked the validity of the "dosing" method of isolating the specific product of a given factor. Others denied that land can be treated as a mobile fund, holding that in this it differs from capital.

To the author, one of the most interesting features of Professor Clark's thought is his philosophical consistency. His social point of view, his optimism, and his minimization of the limitations inherent in the differences in land are manifestations of a pretty thoroughgoing idealism. His hedonistic trend, however, introduces a jarring note.

S. N. Patten. — Professor Simon N. Patten (1852–1922) was one of the most original economists America has produced. His chief economic writings are *Premises of Political Economy* (1885), *The Consumption of Wealth* (1889), *Dynamic Economics* (1892), and *The Theory of Prosperity* (1902). He was an idealist in philosophy, who believed that under social planning a dynamic society experiences increasing utility, growing population with higher living standards, and larger profits. To indicate briefly some of Patten's characteristic doctrines:[2] he developed the importance of consumption, making the changes that adapt it to environment a factor in reducing costs as men progress; he was optimistic, denying a law of diminishing returns; he regarded the shares in distribution as price-determined, costs cutting no figure; and, in order to harmonize the idea of increasing demands with that of increasing returns, he made monopoly normal and gave it a large part.[1] The idea of alternative use and opportunity costs finds frequent expression in his works. Patten pointed out that land will not be abandoned exactly at the point where returns just fail to cover costs of bringing it under cultivation, but that production will be carried further.

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[1] See, e.g., Carver's and Hobson's discussion in *Jr. of Pol. Econ.*, 1904–1905; Carver's discussion in *Quart. Jr. Econ.*, August, 1891; Davenport's *Value and Distribution*, Chap. XXII; MacFarlane in Amer. Econ. Assoc. Pubs., 3d series, Vol. IV, No. 1.

[2] See Boswell, J. L., *The Economics of Simon N. Patten* (1934). For a review of Patten's *Dynamic Economics* by Clark see Ann. Amer. Acad. III, 30–44.

Professors Clark and Patten differ markedly in the place which they give to monopoly. The former gives it scant attention, and its rôle in his theory is unimportant. With the latter the opposite is true. Accordingly, they also differ in the scope which they would allow to government interference, and, while Professor Clark would emphasize private property rights and minimize government activity, Professor Patten would allow to the government an active policy in maintaining the social interest. In his later thought, Professor Clark perhaps made a larger place for government intervention, but it was for the purpose of maintaining his ideal of competition free from restraint.

Irving Fisher. — Professor Irving Fisher (1867–1947) published his *Mathematical Investigations in the Theory of Value and Prices* in 1892; but later summed up his theory in several volumes: *The Nature of Capital and Income* (1906), *The Rate of Interest* (1907), *Elementary Principles of Economics* (1912), and *The Theory of Interest* (1930). Professor Fisher reasoned with admirable clarity, adopting the accountant's point of view.

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[1] "The motives for production increase as wants grow in intensity; but costs fall off with the growth of productive power, thus destroying the equality between it and the return in goods. A new equilibrium is created on the market by the equality of marginal expense and marginal utility. Wants grow more rapidly than productive power; values rise, and producers gain a monopoly power equal to the difference between cost and the expense of goods. Monopoly is thus essential to a market equilibrium, and the monopoly fund has its size fixed by the natural excess of demand over supply. Intense wants and low costs of production have no other means of equating themselves." (*Theory of Prosperity*, p. 234.)

The Austrian idea is the dominant one: the value of capital goods (including land) is the discounted value of their income. And a point upon which much stress is laid is that income must not be confused with the material objects (capital) which afford it, but consists of the services rendered by such objects, the element of *time* making the great difference. The interest rate, the determination of which Fisher would make the chief problem of economics, depends upon the "time preference" (Fisher called it "impatience") of individuals for present over future goods, — an *agio* theory. He undertook to explain interest rates by assuming (1) "income streams" of varying size and character, and (2) the character of individuals (such as foresight, self-control, and habit); but he does not *explain* the income stream, and does not allow subjective costs to function. "Investment opportunity" is made to serve in lieu of both productivity and cost, so that we have a merely individual accounting, which does not explain the determination of "opportunity."

Professor Fisher deserves credit for early discussions of the relation between the value of money and interest rates, and he did important work in support and clarification of the quantity theory of money. In his later years, he went to extremes in advocating attempts to control the general level of prices by manipulating the currency.[1] In general, Fisher's thought shows the tendency, so common among mathematical economists, to make question-begging assumptions, and to deal with variations and "correlations" without regard for causation.

F. A. Fetter. — Frank A. Fetter (1863–1949) is recognized as an original thinker, and one who has a sufficiently fundamental and consistent theory of economics to have become the basis for a distinct group or "school." In his earlier thought, he adopted substantially the Austrian theory; but, while he remained highly subjective and "psychological," he sought to free his thought of materialism and hedonism.[2] Adopting the volitional psychology, he made valuation a matter of free choice rather than of calculation of utility. At the same time, he came to oppose chrematistics, or "price economics," thus running counter to both Fisher and Davenport. He set "welfare economics" against "price economics," arguing that economics must help man to attain some goal.[1] Nevertheless, while rejecting hedonism and criticizing marginal utility, Fetter recognized the importance of value theory, and developed a theory of value and distribution which is not greatly dissimilar to those of such economists as Pigou or Liefmann. In this respect, the chief points are that he tends to ignore physical limitations, and to minimize the significance of cost. For example, he considers interest as due entirely to difference in the present valuations of present goods and future goods, and criticizes Fisher and Böhm-Bawerk for mixing "productivity" with this. His doctrines of "psychic income," and "time value" (unconnected with productivity and rent) became well known.

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[1] E.g., see *Stabilizing the Dollar* (1920), and *100% Money* (1935).

[2] *Economic Principles* (1915).

Quite different from the foregoing are the views of the two former Harvard professors, F. W. Taussig and T. N. Carver.

In addition to his books on the tariff question and *Wages and Capital*, Professor Taussig (1859–1940) published *Principles of Economics* (1911), which is valuable as a restatement or revision of the Classical theories by one who is generally recognized as having been America's greatest teacher of economics. The doctrines of Böhm-Bawerk, Fisher, and others are on the whole skillfully merged into those of Mill and Marshall. The most notable features are the treatment of profits as a form of wages, and the peculiar theory that wages are determined by the discounted marginal product of labor.

Professor T. N. Carver (b. 1865) in his *Distribution of Wealth* (1904), calls a halt to one-sided emphasis of psychology, and points to the economic environment factor. The book contains a noteworthy restatement of the law of diminishing returns, and an able criticism of the Austrian ideas on interest, applicable in a great degree to Fisher and Clark. To Carver the question concerning interest is, "Why is this income more than sufficient to keep the supply of capital intact, or to replace it?" As in the case of value, cost and productivity are synthesized. Unless the supply of capital were in some way limited, its marginal productivity would disappear; and these limits are the cost of making capital goods, and the sacrifice of waiting, including an element of incalculable risk.

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[1] "Price Economics vs. Welfare Economics," *Amer. Econ. Rev.*, Vol. X, pp. 467 f., 719 f. (1920); "Value and the Larger Economics," *Jr. of Pol. Econ.*, Vol. XXI, p. 587 (1923).

There is a sense, Carver holds, in which rent does not enter prices as wages do, for land is separable from the owner and does not have to be persuaded to work by some offer of advantage.[1] In this connection, a tendency to treat the problem of distribution from the standpoint of the entrepreneur and his expenses is to be noted.

Professor Carver laid more stress upon the Malthusian theory of population in connection with the theory of wages than did the preceding writers.

In Carver's thought there is a strong strain of materialism.

Professor Richard T. Ely (1854–1943) exerted a wide influence among American economists. His *Outlines* was one of the most widely used texts in colleges and universities, and through his long teaching career at Johns Hopkins and Wisconsin, he did much to shape the course of economic thought in the United States. Sanity and balance mark Ely's mature work. He may, on the whole, be classed as one of the older Historical School;[2] and his continued emphasis of the significance of social institutions, and especially those connected with property and contract, has been an important factor. Professor Ely, in his earlier days, was criticized for "socialistic tendencies." Time has proved that in reality he stood for a golden mean in social reform that now is the ground upon which the fallacies of real Socialism can most effectively be met.

Professor Edwin R. A. Seligman (1861–1939) in the main followed J. B. Clark in his theory of value and distribution, but his thought was much more eclectic and he regarded the scope of economics differently. In addition to being America's foremost authority in the field of taxation, he published a book entitled *Principles of Economics* (1905), attempting to combine the theories of J. B. Clark and the Austrian School and those of the Historical School, with the older doctrines. The influence of German economic thought is apparent.

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[1] See above, p. 205.

[2] See above, pp. 539 f. Ely's thought also shows the influence of A. Wagner.

Professor H. J. Davenport (1861–1931) had a distinct influence in the United States and England. Davenport's theory is characterized by its adoption of the "entrepreneur point of view" and the related notion of "opportunity cost." His theory assumes prices, and makes marginal utilities and disutilities depend upon them. The dependence works out through the voluntaristic acquisitive choices made by enterprisers among the price-determined "opportunities" which present themselves in markets. While the idea of opportunity cost is found in the Austrian School, and Davenport had this phase of subjectivism in common with them, he rejected both hedonism and the idea that marginal utility is causal. Thus his economics was in important respects more closely related to the mathematical "price economics," or to the narrow exchange-value tendency.[1] But his training was in Classical doctrine, so that real costs and social welfare were always specters; and he was not a mathematician. After much groping, he seems to have fallen back upon a non-causal entrepreneur standpoint as being the easiest way to something definite, if not final. He made his economics consistent and "realistic" by reducing it to the private pursuit of pecuniary gain.

In addition to the foregoing leaders in American economic thought prior to World War I, are to be mentioned such men as F. M. Taylor (1855–1932) whose work in general theory and in money were of high quality, and F. B. Hawley whose discussions of profits had considerable influence. H. L. Moore's work in economic cycles, wages, and supply and demand schedules shows originality.

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[1] See above, pp. 518 f.

This may be called the period of marginal-equilibrium economics. Marginal-utility and marginal-productivity theories grew up. Abstraction of the other-things-being-equal type abounded. The influence of J. B. Clark, the Austrian School, and Marshall was paramount by 1900. Thereafter, for nearly twenty years Neo-Classicism reigned supreme in America.[1]

Criticism and Reconstruction, 1918–World War II. — Then beginning about 1918, came a *period of criticism;* that is, of *effective* criticism. It came in the troubled period following World War I and was characterized, as to economic theory, by the "Institutional approach." The names of Wesley C. Mitchell and John R. Commons became more prominent, and the thought of Veblen was influential.[2] This brought attacks on hedonism in marginal utility, on ethical implications in marginal productivity, and on static economics. The conditions of equilibrium were more critically examined, preparing the way for theories of imperfect competition and attempts at "dynamic" analysis.

But before the twenties were over, the period of criticism developed into attempts at reconstruction, and positive studies began. One can find in this period, down to say 1936, at least four elements: (1) attempts at quantitative analysis by statistics, focusing on business cycles (e.g., Mitchell's work); (2) the development by younger Institutionalists out of impatience with existing institutions into planning new institutions; (3) the attempt of mathematical economists to use "econometrics," (4) the lapse into a sort of agnosticism concerning economic values which sometimes resulted in the extreme abstraction of "ivory-tower" economics. (The last two tendencies had in common a high degree of subjectivism — tending to ignore technological conditions, and assuming that goods exist. Perhaps Fisher may be mentioned as a representative of the third group; Knight, of the fourth.)

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[1] Cf. Schroeder, E. F., *The Marginal Utility Theory in the United States of America*, Nymegen, Netherlands, 1947.

[2] For discussion of Veblen and Institutionalism, see Chap. XXXVI.

These four elements seem to have been most influential until the advent of Keynes's *General Theory* soon after 1936.

During the years 1930–1939, under the influence of the stock market crash and the Great Depression, there arose disillusionment and distrust concerning both democracy and competition, as these had been working. The result was a growing interest in "imperfect-competition theory" and a tendency to accept more "social planning." Monopolistic-competition theory broke out in 1933. And at about the same time, Professor Tugwell carried "the experimental approach" of the younger Institutionalists to Washington: Less competition, more central planning, an entirely different approach to economic theory — "social values" and "social justice."

To this condition is to be added the failure of the monetary policies based upon the quantity theory. The recognized failure of orthodox attempts to control prices by manipulating the quantity of currency ("open market operations") or discount rates, tended to discredit much Neo-Classical thought.

But, as the thirties wore on, unemployment continued abnormally great. When, therefore, in 1937 there came an extraordinarily sharp recession, a highly significant change occurred in the thought of those who favored central control. For this change, the way was being prepared not only by the failure of Institutionalist "social planning," but also by the rise of "monopolistic-competition" theory. Following Chamberlin's book in 1933, interest in the monopoly approach grew, reaching a peak perhaps about 1937 when A. R. Burns's *The Decline of Competition* appeared.

But the change referred to was the change of style in thinking from Veblen to Keynes, marked by the swing to Keynesian policies at Washington. This change meant three important developments in American economic thought: (1) income economics according to which attention became directed toward controlling incomes and forcing circulation, rather than controlling mere quantities of money and levels of interest rates; (2) macro-economics, or the management of aggregates;

(3) "monetary economics," which replaces "real" economics by assuming the value and constant purchasing power of "money" regarded as a mere unit of account, or bank credit. With the ascendancy of Keynesian thought in 1937 came the "national income approach."

This worked with the "holistic" tendencies of Institutionalism; but was opposed in part to the Veblenian antipathy to "pecuniary" motives.

Hardly had the Keynesian "pump-priming" era begun, before the general-equilibrium school of thought gained influence. Hicks's *Value and Capital* came out in England in 1939, and by that time the indifference-curve, mathematical economics, and "econometrics" were well established in America. The earlier work of Fisher, Schultz, and others was succeeded in the forties by the budgetary studies of Smithies, Hart, and others, and by the general-equilibrium models of Leontief, Tintner, Klein, and the rest. These characterized the World War II period.

To be associated with this phase is the movement to make economic theory "dynamic." In the years since 1940, have come such men as Samuelson, Klein, Metzler, Smithies, Tintner, and Lange.[1] Mostly they rely very heavily upon mathematical procedures.

Thus out of distrust of democracy and competition came systems of "political arithmetic," for planning and controlling national aggregates. They were able to work with the American "institutionalism" in that (1) both had "the experimental approach," and (2) both were "holistic."

This represents a phase of subjectivism in economic theory that stands opposed to Austrian marginal-utility theory, as appears in the difference between marginal-utility theory and the indifference-curve approach. It may be taken to free the central authority from the limitations imposed by individual desires for any particular good, as well as from the "real" costs of production. It leads to the "new welfare school" idea of an "optimum" of some sort based either on some concept of well-being or on full employment.

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[1] In a general way, Schumpeter, Haberler, Hansen, and Machlup may be associated with the earlier steps in this direction. Professor J. A. Schumpeter, whose *The Theory of Economic Development* appeared in Germany as long ago as 1911, early grasped the concept of economic life as being essentially a process of change and development, and his theory of cycles rests upon the hypothesis that the mechanics of evolution itself works to produce wave-like movements.

The New Welfare Economics and Socialism.[1] — As the turn of the century drew near, the tendency to criticize and abandon marginal utility and a competitive solution as the basis for organizing economic life brought together three different thought tendencies and focused them on the problem of "social welfare." These three tendencies were the general-equilibrium theory of Barone and Hicks, the full-employment theory of Keynes, and the Marxian theories of central control. The new movement was led by certain Socialistic thinkers such as Lerner and Lange in America and Dickinson in England. Their thought was essentially subjective in that they ignored certain essentials in the problems of producing goods. They assumed that utility as "wants" is important, but only under conditions of equal income. This enables them to substitute for the idea of individual marginal utility operating competitively in a free economy the idea of an aggregate optimum in a controlled economy.

The new welfare idea is based on the assumption that individual marginal utilities are not measurable. This assumption appears in the general-equilibrium analysis, where the indifference curve replaces it. An indifference map on which there may be many indifference curves is the result. But this leads to the concept of some total well-being upon which the "optimum" condition must depend. At this point the general-equilibrium approach appears to break down as a scientific procedure. The dictator is called in — the central planning board.

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[1] See Bergson, A., "Socialist Economics," in *A Survey of Contemporary Economics*, Ellis ed., 1948; Myint, H., *Theories of Welfare Economics*, 1948; Reder, M. W., *Studies in the Theory of Welfare Economics*, 1947; Lange, O., "On the Economic Theory of Socialism," in *On the Economic Theory of Socialism*, Lippincott, ed., 1938; *idem.*, "Foundations of Welfare Economics," *Econometrica*, 1942; Lerner, A. P., *Economics of Control*, 1944; Sweezy, P. M., *The Theory of Capitalist Development*, 1942; Schumpeter, J. A., *Capitalism, Socialism and Democracy*, 1947; Wright, D. McC., *The Economics of Disturbance*, 1947.

The Keynesian and Marxian approaches are more simple in a way and certainly more objective. The Keynesian thinker sees welfare as synonymous with full employment and employment in terms of the "wage unit" which is essentially labor-time. Similarly, Marxian thinkers, while revising the labor cost theory of value, are forced to accept some non-economic standard of performance per man-hour. The idea seems to be to assume (1) "comparability of utilities" as a basis for normative control over production and use, and (2) to set up a central board to allocate resources without regard to actual differences in ability or disutility as they exist among different individuals.

The general criterion of optimum conditions appears to be the requirement that price shall equal marginal cost without any allowances for profits. The question as to what is to be included in cost, however, remains vague and is the source of much discussion and disagreement. The centralist group which stems from Marxian thought appears to favor the use of "fixed coefficients," which is just another way of saying that technical problems only would be considered — no values — for the short run at least! The "competitive" solution group which stems from the general-equilibrium or Keynesian approach breaks down into two groups. One sub-group would endeavor to make some use of the idea of consumer sovereignty and presumably allow firms to make a profit. This, however, appears to suit no one. The other sub-group would have firms run by a salaried manager. After all, while there may be some difference in spirit or attitude, this idea seems to come close to the centralist approach. The whole tendency is to set up a concept of "social value," assuming a "scale of social values" which in the last resort requires an authoritarian origin.

Those who are thinking along these lines in America appear to be such men as Lerner, Lange, Bergson, and Sweezy. Their ideas have been criticized by F. M. Taylor,[1] Mises, Hayek (England), Schumpeter, Wright, Graham, and Knight.

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[1] "The Guidance of Production in a Socialist State," *American Ec. Rev.*, 1929, reprinted in *On the Economic Theory of Socialism*, 1938, together with a discussion by O. Lange.

Leading American Economists Since 1920. — The outstanding general theorists between 1920 and 1945, the end of World War II, may be said to include: J. M. Clark (theory of production, costs, and social tests of efficiency); F. H. Knight (risk, uncertainty, profits, and psychological and philosophical background);[1] J. Viner (international trade); E. H. Chamberlin (price and imperfect competition); M. A. Copeland (monopolistic competition, and national income analysis); J. W. Angell (investment and business cycles); F. D. Graham (international trade and social goals); S. H. Slichter (labor and institutional factors); A. H. Hansen (cycles, fiscal policy, monetary equilibrium, stagnation); A. W. Margèt (theory of prices). The work of P. H. Douglas (wages and marginal productivity) and H. Schultz (mathematical price theory), both deceased, insured them a permanent position, the latter being notable as the author of *The Theory and Measurement of Demand* (1938).

With the exception of Hansen, these men have been either untouched by Keynes or opposed to Keynesian doctrines.

In addition, this period was marked by active and valuable contributions by a number of foreign-born and foreign-trained economists who have made permanent places in American economic theory: J. A. Schumpeter, L. Mises, W. W. Leontief, G. Haberler, and F. Machlup. Of these, most have the Austrian background.

Finally, in the more recent post-Keynes period of the forties, economic thought in America has been in a turmoil, with a majority of those whose names attract most attention concerned with macro-economic schemes for a more or less managed economy. Several of the younger men who stand out have been mentioned in the discussions of Keynes, general equilibrium, and monopolistic-competition theory. They range from such near-Keynesian or moderate Keynesian thinkers as D. McC. Wright,[1] W. Fellner,[2] and P. Samuelson,[3] to the radical Marxian type economists such as O. Lange,[4] L. R. Klein,[5] and P. M. Sweezy.[6] But the names of the great body of American economists will be found among those who have written some monograph or article upon some special branch of economics. And throughout the period, while the foregoing theories were debated in journals and the younger men did "government work," probably a majority of the older economists in the colleges and universities clung to their micro-economics, and discussed price problems in Neo-Classical "opportunity-cost" terms. An increasing number of able economists found employment with large corporations and trade associations.

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[1] Knight is notable as a critic. His general position is indicated by saying that he believes utility can be measured approximately in quantitative terms, accepts competition as desirable, and opposes the Keynesian system; but, like J. B. Clark (from whom his thought appears to stem), he holds that capital is a mobile fund or perpetual stream of services, and that profits are not necessary and tend to disappear except under conditions of uncertain change. See *Risk, Uncertainty and Profit*, 1921; *The Ethics of Competition and Other Essays*, 1935; "The Ricardian Theory of Production and Distribution," *Canadian Journal of Econ. and Pol. Sci.*, Vol. I; "What is Truth in Economics," *Jr. Pol. Econ.*, 1940; "The Place of Marginal Economics in a Collectivist System," *Amer. Econ. Rev.* (suppl.), 1936; "Realism and Relevance in the Theory of Demand," *Jr. Pol. Econ.*, 1944; "Interest," "Demand," etc., in *Encyclopedia of Social Sciences*.

At first generally recognized as a hopeful sign as to the future significance of economics in America, has been the employment of economists by the government. As early as 1893, Professor Folwell could say before the American Economic Association: "We seem already to have made some impression on the public. One of our members has been called to assist in framing a system of taxation; a second to assist the national railway commission; a third to give testimony in a case involving municipal ownership of gas works." [7]

This tendency grew. Among the earlier economists, men who did notable work are H. C. Adams, formerly of the Bureau of Statistics and Accounts of the Interstate Commerce Commission; J. W. Jenks as agent for the United States Industrial Commission (1899–1901), and special commissioner for the War

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[1] *The Economics of Disturbance*, 1947.

[2] *Monetary Policies and Full Employment*, 1946.

[3] *Economics*, 1948.

[4] *Price Flexibility and Employment*, 1944.

[5] *The Keynesian Revolution*, 1947.

[6] *The Theory of Capitalist Development*, 1942.

[7] *Amer. Econ. Assoc. Pub's*, VIII, pp. 31–32. The men so employed were, respectively, R. T. Ely, H. C. Adams, and E. W. Bemis.

Department to investigate currency, labor, etc., in the Orient; W. F. Willcox as census statistician; B. H. Meyer, first as head of the Wisconsin State Railway Commission, then as a member of the Interstate Commerce Commission; E. D. Durand in the Bureau of Corporations and later heading the Census Bureau; Francis Walker as economist to the Federal Trade Commission; and H. P. Willis in connection with the Federal Reserve System.

Then World War I greatly increased the government service done by economists. Beginning in 1933 the "New Deal" administration called many (mostly the younger or less conservative ones) to Washington. Finally, came World War II; and the War Production Board, Office of Price Administration, and many other government agencies swarmed with economists dealing with the problems of a so-called "war economy" and the ensuing problems of "reconstruction." In America it is quite generally the case that academic economists have had experience, as experts or executives, in some branch of government service, state or Federal.

It seems probable that in the long run the connection between economic and political values may work for the clarification of both. There is some reason, however, to fear that, just as the service in business may sometimes lead to bias in favor of individualism or elements of private monopoly, so service in government may sometimes encourage a tendency to favor wasteful experiments and to practice that tyranny which lies in the equal treatment of unequals.

Some Summary Observations. — At the beginning of the twentieth century, it could be said that American economic thought was mostly an eclectic mixture of (1) the ideas of the Austrian School and J. B. Clark with (2) the English Classical and Neo-Classical economics of Mill and Marshall, somewhat tinged by (3) the remains of the preceding Historico-Ethical movement of the eighties.

With the great development in corporate industry, and in accountancy and statistics, there came a growth in "business economics" and "commercial" subjects. At the same time, and doubtless connected therewith, the tendency toward "price economics" set in, with such diverse but related manifestations as Davenport's enterprise economics and Fisher's mathematico-accounting economics. This tendency was facilitated by a revulsion against the marginal utility and marginal productivity analysis.

About 1918, accentuated by World War I, the older type of "welfare economics" and "Institutionalism" began to grow, based on the thought of such men as J. A. Hobson and Veblen, and aided — in different ways — by Commons and Mitchell, and by Fetter's reaction from hedonism and price economics. (The typical underlying philosophy and psychology of the people responded to William James and Bergson, and volitionalism and "behaviorism" affected economic thought.) This phase may be regarded as a reaction from the preceding "price economics" phase.

Then came the younger Institutionalists, followed by "monopolistic competition" and the Keynesians. These throve on war and depression which prevailed much of the time between 1914 and 1946. The period is to be considered as one in which men sought relief from insecurity by group "planning."

In order to understand American economic thought, it is necessary to remember that volitionalism and a subjective idealism have been the prevalent underlying tendencies in America. The typical "American" tends to believe that "man" can conquer "land," either individually or collectively (through institutions). He tends to revolt against the reign of law. Accordingly, American economics has tended, when left alone, to break down either into "price economics" (which avoids the issue), or into a socio-ethico-institutional "welfare economics."

The American spirit is as restless and inquiring as the German; but it is more empirical, and less philosophical. It is as optimistic as the French; but is more idealistic, and less submissive to the rule of nature. It is as practical as the English; but is more radical, and less empirical, objective, and utilitarian.

E. GENERAL APPRAISAL

CHAPTER XLV

THE EVOLUTION OF ECONOMICS EPITOMIZED

General Résumé. — All the history of economic thought may be divided into two parts: one of these embraces the era before the establishment of economics as a science; the other extends from the rise of that science to the present time.

The Prescientific Period. — It is not to be inferred from this statement that economics suddenly sprang into being as a full-fledged science, nor that it has subsequently attained complete unity, or freed itself from all unscientific thought. But this can be said: we can speak of a prescientific period, in which economics was conceived of neither as a separate body of doctrine, nor as a social science. In this earlier era, economic thought was mingled with religious and ethical doctrines and with legal institutions, and did not exist as a distinct body of theory. This was the case in the ancient world and in the Middle Ages. Nor was there sufficient separate interest in economic matters to cause further development; for with Hebrew and Hindu, Greek and Roman, and Scholastic alike, we find, on the one hand, but a rudimentary development of division of labor and exchange, and of such stimulating economic phenomena as those concerning public finance and the labor problem. On the other hand, hostile ethical and religious concepts so dominated men's minds, as to hinder speculation about such economic problems as existed. Wealth was little appreciated by the leading thinkers.

Furthermore, there was little of "science" in any field of thought — little of the concept of objectively established relations of "cause" and "effect." The birth of the so-called natural sciences is commonly dated from the work of Galileo (1564–1642), Harvey (1578–1657), and Newton (1642–1727). And the concept of scientific law is more difficult in the case of social phenomena, where the limitations of policy and art are not so easy to see, and where what "is," is confused with ideas of what "ought" to be.

Throughout the prescientific period, men for the most part believed in a "just price" for goods and services, a belief normally accompanied by minute regulation of industry. Perhaps the other most notable points in the prescientific stage of economic thought are the discussion by Greek philosophers of division of occupation, "natural" uses, and communism; the Roman jurists' treatment of money; and the medieval doctrines concerning "just price" and usury.

With the rise of nations and the growth of money economy, came the Mercantilist period, which is transitional and marks the dawn of Economics as a science, — though it was but the first faint flush announcing what was soon to be. Economic topics were given more frequent, extended, and, above all, more distinct attention. Wealth was highly appreciated. Its chief source was considered to be commerce, partly no doubt on account of an overemphasis of "treasure." In their empirical studies and policies concerning foreign trade, balance of trade, stimulation of industry, and taxation, the Mercantilists laid the foundation for further development. In general theory, some fragmentary discussions of value and money, and the analysis of the factors of production are noteworthy.

The Beginning of Scientific Economics. — The real founding of the science of Economics, which marks the rise of the second era, came to pass about the middle of the eighteenth century. This was closely associated with the contemporaneous development in natural sciences, and the revolution in social philosophy. The idea of a science was drawn from other fields; and the philosophy of "naturalism" (the universal reign of natural law) fed upon this and the revival of the old "nature" philosophy. Then it was that — led by a physician who had learned something about the circulation of the blood — the Physiocrats, or *Les Économistes*, partly in reaction against Mercantilistic policies, elaborated the old Greek idea of nature and natural freedom as handed down through the Middle Ages. Wealth, they held, comes from nature, and arises from her bounty. Agriculture, instead of commerce, thus took the center of the stage. And in the place of authority and regulation, *laissez faire* became the watchword.

The service of the Physiocrats was largely negative, consisting in greater freedom from hampering regulations and taxes.[1] More positively, their scheme of distribution became the father of succeeding attempts to trace the round of production, exchange, distribution, and consumption. Their emphasis of land and its surplus (*produit net*) was an influential conception. And, above all, *their attempt to formulate a body of positive principles, separate from morals, politics, and jurisprudence, gave economics its first claim to be a science.*

Adam Smith clinched that claim. His work was fuller and more comprehensive than that of Quesnay or Turgot, and the firm establishment of Political Economy may justly be dated from the *Wealth of Nations* (1776). Economics became associated with a body of causal explanation of economic phenomena. More especially, under Smith's leadership it developed around the significance of the objective and quantitative values of commodities and services as observed in exchange. In short, "the price system" became the basis of economic science.

Smith took the sole emphasis away from production, putting the consumer more to the front, and in doing so prepared the way for a broader treatment of economics. Building upon the thought of English predecessors and the Physiocrats, and influenced by a different and more highly developed industrial environment, he turned from "nature" or agriculture as the source of wealth, and gave to labor that position. He also presented a more comprehensive discussion of value and the shares in distribution than any predecessor. While an individualist, and, on the whole, a believer in free trade and *laisser faire*, he was more of an opportunist than the Physiocrats, and was less rigid and absolute in applying his doctrines. Some of his followers wrote more accurately and consistently than he, but Adam Smith excels the great majority of them in breadth of view, and there came a time when many economists turned back to the Father of Political Economy rather than to his immediate successors. Much of what is here written concerning the Classical School will apply to him only in part.

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[1] See above, pp. 202 f.

Smith, and to some extent the Physiocrats, were influenced not only directly by the development of natural science, but also by its effects upon psychology. The idea of an "economic man," governed by a few fixed and powerful instincts — the idea of an "average man" reacting uniformly to his physical environment — was an important basis for the idea of economic law. Materialism, sensationalism, empiricism — these were present at the birth of the young science.

Too often, moreover, the science of economics has been unscientific! Unconsciously the founders were influenced by the particular set of institutions with which they were associated. Class bias, religious teleology, and ethical ideals have warped scientific thought to this day. The meaning of science is itself not free from question, and particularly so when human life is involved and the problem of "goals" thus arises. But, while subject to change, the idea of "uniformities" in social phenomena has prevailed from Smith's time to the present, and warrants calling this period the era of scientific economic thought.

Classicism. — The *Wealth of Nations* soon gained more or less of an ascendancy in the leading countries, and the followers are mostly to be classed as members of the Classical School. There were, however, three main branches, corresponding to as many different national environments.

(1) In England, a group of economists, with whom the designation "Classical School" is generally associated (and chiefly of whom what follows is written) centered around Ricardo, accepting his doctrines of rent and adding the Malthusian principle of population. Bentham's utilitarianism was adopted, and

this not only tended to eliminate Smith's "nature philosophy," but also to introduce a more strongly hedonistic basis.

With this group, the problems of distribution of wealth were for the first time given chief attention, and these they considered mostly from the point of view of the individual entrepreneur. The main framework of their economic thought consisted of the theory of value and the "shares" of the factors of production, land, labor, and capital. In their reasoning, the interests of the "factors" were made more or less antagonistic, and their views tended toward pessimism, — a tendency usually connected with materialism and individualism. Value was regarded as cost-determined, and was treated as an objective phenomenon by the dominant element.

(2) In France, J. B. Say (1803) contributed to the arrangement and classification of the new science. There, a larger element of the eighteenth-century nature philosophy remained, and the attacks on Socialists and protectionists were stronger. (In France the earliest nineteenth-century Socialist propaganda flourished.) The general tendency among French Classicists was to reject pessimism and the laws of population and diminishing returns, and to develop a negative sort of idealism based on harmony of individual interests. The optimism of Dunoyer and Bastiat resulted. "Liberalism" was the term which came to be applied to French Classicists and in general to the continental followers of the English Classical political economy — the term implying individual liberty in the sense of equal opportunity.

(3) In the first half of the last century, German economists, largely on account of their Kameralistic background, had a somewhat different notion of economics. Though Smith had a small group of close followers, Ricardo was not so generally accepted, and abstract theorizing on problems in distribution is not often found. The significance of national lines and moral forces was more recognized, and administrative and financial matters were given more attention.

Remembering the differences among its branches, and its relatively slight hold on Germany, it may be said that the members of the old Classical School stood for certain philosophical tendencies, a closely associated methodology, and a group of characteristic economic doctrines.

As to their philosophy, it was, speaking generally and in a pretty sweeping fashion, materialistic utilitarianism. They considered tangible, material things; they were individualistic — "the alliance of political economy with Utilitarianism may be said to have given a new lease of life to the individualism of the eighteenth century";[1] they were hedonistic, emphasizing deliberate calculation of pleasures and pains almost to the exclusion of habits and instincts. Yet the development of economics along truly scientific lines was hampered by the dominance of an ethical element in their thought which was based upon the preceding individualistic nature philosophy; for "freedom of competition" was made an ultimate test. The results of perfect freedom were not to be questioned. Freedom, moreover, was generally a purely formal concept, meaning freedom from legal restraint, and the like, rather than real economic freedom. Hand in hand with this philosophy went an abstract-deductive method.[2]

Some of the most marked characteristics of the doctrines of the Classicists may be stated as follows. To them, value generally meant objective exchange value. Estimation by the subject received scant attention, — though this is less true of France than of England. Accordingly, the part played by utility was underemphasized. Value was regarded as determined by cost, and throughout a greater part of the Classical period there was a constant tendency to emphasize labor-pain costs as the ultimate thing. Such cost, however, they sought to measure objectively, generally as time and expense.

The Classicists often confused the entrepreneur with society, shifting their point of view from one to the other; for there was no clear appreciation of the distinction between the idea of ultimate social costs and the expenditures of the business undertaker. Their system, furthermore, considered exchange values as the ultimate thing: wealth equaled a quantity of exchange value. Accordingly, little attention was given to public wealth as distinguished from private riches; and, while a clearly avowed limitation of the scope of the science to objectively measured exchange values is quite permissible, there was point to the criticism that the broader considerations were slighted and confused with the narrower by them. Their idea was that welfare depends upon a stock of material goods, and production was encouraged, without due allowance for the significance of the law of diminishing utility. Lacking the idea of marginal utility, they did not realize the limitations of their point of view.

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[1] Bonar, *Philosophy and Political Economy*, p. 219.

[2] Cf. above, pp. 21 f., 309.

The School held to the tripartite division of the factors of production, — land, labor, capital, — and emphasized the distinctness of each. All believed in the peculiar importance of land and the margin of cultivation, but there was a split in the ranks over the merits of the landholders' interest. The Classicists of the dominant type, however, all consciously or unconsciously upheld the interests of capital and of the capitalist class, making capital an independent factor upon which labor was thought of as being largely dependent.

Needless to say, the foregoing principles and theories found expression in the advocacy of a body of rules of action, the art of applied economics. Such rules as concerned poor-relief, tariff, taxation, and organized labor are well-known examples. The members of the Classical School were largely practical in their purposes and much of their thought appeared in pamphlets dealing with the issues of their day.

Critics of Classicism. — Almost as soon as they began to take shape, critics rose against these philosophical ideas, methods, and economic doctrines; and as they grew and hardened, dissenting schools came into existence. Several of the earliest critics (e.g., Lauderdale, Rae, Sismondi) accepted individualism and materialism in part, but stood for a recognition of the lack of harmony between public and private interests, and for a contrast between utility and exchange value. With an unconscious ethical basis, the possibility of overproduction was implied or stated.

Next one notes a Nationalistic criticism, a criticism most characteristically German, though it found expression in America. Attacking the validity of the cosmopolitanism of the Classical theory, such men as Adam Müller and Friedrich List stressed the importance of the state and of national lines as limiting the application of economic laws. Such thinkers were idealistic in their tendencies, one evidence of their idealism being their exaltation of the political institution and their opposition to individualism. They opposed free trade as a general rule.

Then Socialism presented a still more radical opposition to the dominant Classicism. Beginning with the Utopian, bourgeois thinkers such as Saint-Simon, Owen, and Fourier, the Socialistic thought tendency reached a climax with the materialistic and revolutionary doctrines of Marx and Engels from 1848 on. As Socialism developed, it underwent a striking transformation in philosophy. From idealism, it passed through an attempt at realism to materialism. From associationism, through nationalism (State Socialism) it passed to internationalism. This development attended a growing revolutionary aspect. Now, more lately, with more opportunist and "evolutionary" tendencies, the materialism of Marx has been questioned. Socialism as a *positive* force is logically connected with the philosophy of idealism.

As a school of economic dissent, Socialism has brought the question of distributive justice to the front, has led to the study of such postulates of economics as the "rights" of private property and contract, and has made economists thresh out such questions as the labor theory of value and the idea of surplus.

Meanwhile, especially in Germany and England, signs of a coming revolt against the dogmatism of the Classical School appeared in the forerunners of the Historical School. Sismondi, Müller, and List, and Richard Jones may be mentioned, and the significance of the French philosopher, August Comte, in this connection is not to be forgotten. While the preceding opponents had assailed the philosophical and ethical system of the Classical School, this movement was primarily directed against the *method;* though it was necessarily closely related to the philosophy[1] on the one hand, and the logic of the theory on the other. It was stimulated by the Hegelian philosophy, and by the current developments in jurisprudence, philology, and ethnology.

But before the historical movement could culminate, John Stuart Mill attempted a restatement of the Classical system, his *Principles* appearing in 1848. Mill's face was turned toward new things, but his mind was filled with the teaching of Ricardo. The result is that his work has been justly called unfinal and transitional. We know that he was influenced by the Saint-Simonians, Thompson, and other Socialists and social reformers. The criticisms of Sismondi and Rae were well known to him. Certainly his strong idealistic and humanitarian tendencies, his belief in man's power to modify industrial conditions for the better, and his distinction between national and individual wealth are evidences of a partial alignment with the forces of dissent. He was hardly affected, however, by the beginning of the movement for a more concrete and historical method; though his logical training led him to state his premises more clearly than the great majority of his predecessors.

Mill's *Principles* is more largely devoted to what is sometimes called social economics than were the works of most of the Classicists; and dynamic problems, such as the future of the labor classes and the tendency of profits to a minimum, are given much attention. His discussion of the grounds for government interference is notable. The chief contributions in pure static theory are his treatment of value and international trade, though even here the unfinal element appears, and the theory is not fully coördinated and digested. In fine, Mill's restatement could not be permanently accepted. While its style, spirit, and sound logical merits long gave it a wider reading than any other English work on economics, it was built of diverse elements which were not closely enough analyzed or consistently coördinated.

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[1] The question of method is apt to depend upon the belief in "laws," and that, in turn, is apt to depend upon the acceptance of a materialistic or idealistic philosophy.

Later Classicists (Fawcett, Cairnes) attempted to give a more precise and consistent use of the terms or statements of definitions, and at points refined and perfected the analysis of the forces of distribution;[1] but the Classical economists fell into considerable disrepute. (Only the Liberalists, notably in France, have continued to hold their main position with little modification.)

Contemporaneously with Mill, the scattered tendencies to revolt against the abstract-deductive methods of the Classical School were brought to a head and fully developed by the German Historical School, beginning with Roscher, Hildebrand, and Knies. While having a deeper significance in its emphasis of socio-ethical factors, this School led chiefly to what became a rather barren discussion of methodology. There was a corresponding, though less influential, movement in England.

All the time, too, German and later American economists were working toward an analysis of gross profits, which led to important developments in the theory of capital, interest, undertakers' gains, and pure profits;[2] and during Mill's lifetime the assaults of English and American writers (Longe, Leslie, Thornton, Walker) led to the almost dramatic downfall of the wages-fund theory.

Neo-Classicism, or "Value Economics." — One little spring which had begun almost unnoticed to trickle into the troubled current of economic thought has not been mentioned. This was the idea of emphasizing the subjective factors in valuation. Suggestions of the idea had appeared here and there, but Lloyd (1834) and Gossen (1854) first made it exact by distinguishing marginal utility, the latter's treatment being much the fuller. Then, in the seventies, Jevons, Walras, and Menger won a hearing for the idea, and further progress was made toward utilizing it in the explanation of market values.

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[1] See above, pp. 689 f.

[2] See above, pp. 563 ff., 717.

It was under the stimulus of the marginal-utility idea that a new school arose which, while largely following the Classical School in philosophy and method, sought to go deeper into the *cause* of economic value, and to reconstruct its theories upon a *subjective* basis. This is the significance of the Austrian School. Menger was the Austrian pioneer; Wieser will ever be remembered for his work on the general theory of value; and Böhm-Bawerk, while doing excellent work in the same field, has gained most prominence in the particular problem of valuation of capital, and interest. Philippovich was the author of some of the best-balanced work by this school. A leading motive of the school has been its desire for unity and consistency in theory, — a desire which finds expression in rebellion against the two-sided determination of value by demand (utility) and supply (cost), — and a great service has been a more unified and consistent application of principles of valuation. The influence of the school has been deep and widespread, being very noticeable in America.

Meanwhile, the theory of evolution had begun to affect social science, and Herbert Spencer's thought concerning sociology and ethics became a factor. This involved the concept of society as a sort of non-biological organism in which differentiated parts tend to function in *equilibrium*. It was associated, too, with a system of ethics which calls that "good" which conduces to life, so that (1) the test of *survival* is made an important factor, though modified by (2) a faculty of ethical judgment which develops in individuals as a sort of by-product of evolution (and is thus itself related to survival).

The two foregoing influences, subjectivism and evolutionism, are among the more important factors which have entered in a positive way into the development of economics since 1870. And, of course, related developments in psychology and in sociology have also had their effects upon economic thought.

These things profoundly affected the concept of the individual, the concept of value, and the concept of scientific law.

"Classicism" is in essence the belief that "laws" govern social phenomena, including value; in other words, that causal "forces" exist and tend to establish an equilibrium. As we have seen, however, the Classical economics made imperfect and erroneous assumptions concerning the nature of the individual and his relation to society, and had a one-sided and inadequate theory of value. Its metaphysical notion of "natural law" was not conducive to science as now understood.

The subjective economists, and particularly the Austrian School, with their "marginal" analysis (they discovered the marginal man), made short work of the labor-cost theory of value. But, while the Austrians were Classicists in spirit, their extreme subjectivism and their hedonism, prevented them from developing a complete theory of market values and distribution in society. They lacked a complete basis for explaining economic equilibrium, and were unable to take the place of the Classical economics. (For the most part, they have tended toward the Neo-Classical or the Matnematical Schools.)

Out of this situation, there developed a Neo-Classicism, and several tendencies reacting therefrom.

The leading Neo-Classical movement occurred in England, where the Cambridge School, led by Alfred Marshall, became predominant. It seeks to combine the valid criticisms of the dissenting groups (Historical, socio-ethical, subjective) with the sounder portions of the Classical theory, and, in the light of an evolutionary sociology and ethics, to construct an *equilibrium economics* which centers in a causal theory of economic value, with a closely related theory of distribution. Thus the marginal-utility idea is accepted, not as supplanting the Classical theory of value, but as a refinement on the subjective or utility side. Value remains an objective point of equilibrium between utility and cost, or the "forces" expressed in demand and supply. Something of self-interest motivation — and a touch of hedonism — remains, but is much modified by a realistic and agnostic evolutionism. Neo-Classicists cling to a modified-utilitarian social point of view. A considerable but not very active body of economists in America, France, and Italy is in accord with Neo-Classicism, and not a few in England and Germany.

Reaction from Neo-Classicism. — But others have reacted from Neo-Classicism in five chief groups: (1) The price economists, (2) the welfare economists, (3) the Institutionalists, (4) the monopolistic or imperfect competition theorists, and (5) the followers of Keynes.

(1) A part of the Lausanne School[1] (based on Walras), Cassel, Fisher, and other mathematical economists, reduce equilibrium to an "equation" — the "general-equilibrium economics." They seek to eliminate philosophical and psychological considerations, and either subordinate or reject the idea of value determination by causal forces. They begin with prices, and study their movements, not the "forces" which determine them. They take an individual point of view, which tends to narrow the scope of economics. This "school" is not fundamentally opposed to the doctrines of Classical economics. It is merely a-Classical, — or pseudo-Classical.

Closely affiliated in tendency, though non-mathematical, is the "price economics" or "enterprise economics" of Davenport and his followers.

(2) Though not always consistently adhered to, and sometimes mixed with Neo-Classical economic doctrines, the "welfare economics" (e.g., Hobson's) tends to reject the quantitative "value economics" of Neo-Classicism, and finds mathematical "price economics" completely inadequate. The basic tendency is to deal with qualitative values — that is, with the goals or ends of life. Thus they emphasize socio-ethical factors. Recently a neo-welfare approach has developed out of the attempts of the mathematical "general-equilibrium" school to find an optimum allocation of productive agents under more or less controlled conditions. This is often associated with Socialism.

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[1] Members of this school are not in entire agreement, and some closely approach Neo-Classicism.

(3) The anti-Classical (and anti-Neo-Classical) tendency in economic thought has come to center in the "institutional approach," as exemplified in different ways by Veblen and Commons in America, and by Spann's Neo-Romantic "Universalism" in Germany.[1] "Institutionalists" base their thought either upon a behavioristic psychology and "instincts," thus rejecting the "value economics" and its traces of hedonism; or upon a study of legal institutions and doctrines; or upon the authority of the state and the "duties" of individuals thereto. In one way or another they all contemplate a regimentation of individuals. They are opposed to all equilibrium doctrine, and tend toward social planning. This brings them into touch with the welfare economics.

(4) Various theories based upon impure or imperfect competition have undertaken to show the limitations of a theory of value and distribution based upon the assumption of pure or perfect competition. This approach suggests that more government control is required in order to get the benefits that pure competition might give.

(5) Keynes's national income approach has not only drawn much attention to the aggregates of "macro-economics," but has led many economists to accept the idea of a "managed economy" as required for central control over individual saving, and thereby to attain some social goal such as "full employment."

Continuity and Environment. — The history of economic thought affords abundant evidence both of the influence of his environment upon man, and of man's reaction upon his environment. The molding influence of those physical and psychological laws which so largely determine the economic situation, social institutions, and intellectual plane is clearly evidenced in the evolution of economic theory. These latter factors both (1) decide what problems shall confront man, and, on the other hand, (2) so act upon the man himself as to modify, though not solely determine, his point of view.

In the ancient world, we find an independent domestic economy and slavery, with little trade, and government revenues largely from royal estates and conquest. Production was simple, and little industrial capital was used. The functional importance of distinctions between land and capital and labor was unrealized. No theory of distribution arose. Personal values (for "use") and personal distribution were considered.

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[1] See above, pp. 404, 824.

In medieval times, trade grew and slavery declined. Exchange value became more important. But labor was the chief factor, and there was relatively little economic competition. So the concept of "just price" was developed, and was based chiefly on the labor involved in producing goods.

The Mercantilists found trade less local, and a growing national economy. They found the "domestic system" of manufacture arising, and the beginning of a free labor class. So their chief problem seemed to be to get "treasure" for the state by international trade, while they sought to stimulate domestic manufactures and employment, partly by giving greater internal freedom to industry.

The cosmopolitanism of Adam Smith and the Physiocrats, and their interest in the problem of distribution among partly functional economic groups, came with developments in trade and industry which conditioned their thought.

Ricardo's thought had the factory system, fixed capital instruments, and a permanent factory labor class, as its background.

More recently, the problems of monopoly and of credit have come before the economist.

Thus, in the Middle Ages, the economic situation was changed by the growth of commerce and a money economy; and, on the one hand, new problems concerning value and interest were presented, while, on the other, men were to some extent shaken out of their asceticism. Physiocracy was associated with land ownership by the Physiocrats. Smith's economics was influenced by the "domestic system" of manufacturing; Ricardo's by the factory system. In more recent times, the capitalistic organization of industry, banking and finance, and the growth and organization of the wage-earning class have effected profound changes in problem and point of view.

Similarly, such social institutions as the "rights" of private property, contract, and inheritance, and the forces of custom and government activity, in their development, have modified economic theories. (Few would deny that Classical economics — perhaps for good and sufficient reasons — came to involve a defense of broad rights of private property, or that much of the more recent "welfare economics" has been influenced by an interest in the "rights" of organized labor.) This is especially true in the case of the more practical rules and doctrines, for into the formulation of such rules and doctrines the prevailing social order enters as a more or less consciously adopted premise.

Finally, the general intellectual progress finds expression in economic theories. Now it is some development in the methods of natural science, now in philology, again in jurisprudence or philosophy. We see this interrelation, for example, in the progress from the theological "stage" to rationalism, and in the methodological disputes of the nineteenth century. We see it again in the influence of the theory of evolution.

In brief, a large part of economic laws are relative to time and place.

But, as already pointed out,[1] economic theory has been in its turn a positive force reacting upon economy, social institutions, and other sciences. And this is notably true at the present time, when no one can look around without realizing that through legislation based upon economic principles his life is increasingly modified (taxation, labor legislation, corporation laws, etc.).

It would be a mistake to maintain either that there are no absolute general principles, or that all economic thought is the product of the economic environment. In fact, in emphasizing the relativity of economic doctrine, men have often been too prone to overlook the element of direct continuity, which has handed down the theories of individual thinkers or groups of thinkers to successors, so connecting one time or place with another in a more absolute way. From the many illustrations of such continuity which might be presented, only a few can be mentioned. The case of the nature-philosophy idea is a classic one.[1] Appearing in Greek philosophy, it was formulated in Roman law, elaborated by the Scholastics, made a basis of the Physiocratic system, and is found as a taint in the logic of the Classical economics. Quesnay's *Tableau* had mottoes from Socrates and Plato's *Laws*.

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[1] See above, pp. 236, 419.

Aristotle expressed certain ideas about the barrenness of money and injustice of interest; these were repeated by the Schoolmen; and the Mercantilists of 1690 were still talking about the moral justification of interest. Xenophon was continuously read, and is referred to by the Mercantilist, Davenant.

Cicero drew his ideas concerning labor directly from the Greeks; Hutcheson his from Cicero; Smith his, in part, at least, from Hutcheson. The labor theory of value well illustrates the idea. The Mercantilists — to go no further back — had the idea of labor as the father of wealth; this idea found expression in Adam Smith and Ricardo; and was adopted by the Socialists as a leading doctrine.

Or, take Kameralism. The Kameralists drew largely upon the *Corpus Juris Civilis*,[2] and German economics, with its practical bent and emphasis of the juristic side, sprang from Kameralism.

To what extent were Gournay's views what they were because he was a merchant, and to what extent because he studied and translated Gee and Culpeper? We know that Süssmilch read Petty, that Sonnenfels followed Süssmilch, and that Malthus studied Sonnenfels. Even Ricardo acknowledges indebtedness to Turgot, Steuart, Smith, Say, and Sismondi; while Mill was deeply affected by his studies in the works of various writers who dissented from Ricardo's views. Cassel obviously draws on Walras. Keynes's system is largely built of parts taken from Hobson and Wicksell, who in turn drew on earlier thinkers; and Keynes profoundly affected American economic thought.

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[1] See above, pp. 64, 70, 74, 177 f., 235, 250 f.

[2] The Kameralists were also influenced by contemporary English thought. (See above, pp. 153, 156 n.)

Certainly one cannot but be impressed with the fact that it is an extremely difficult matter to trace an idea to its ultimate source, and that in many, many instances a theory may be traced directly back through a series of writers. Of course, the fact that the idea was adopted may have been due to local environmental conditions. It can hardly be denied, however, that a characteristic disposition of the thinker is a factor, and that, throughout all the course of economic thought, the thinkers have been directly interrelated through their writings in an important way.[1]

Some Main Points of Difference in Economic Thought. — a. *Ethical Dissent from Exchange-Value Basis.* — The general outline of the rise and fall of economic schools has been traced in the foregoing résumé. Throughout the movements and tendencies so sketched, one thread runs which should be mentioned in this summary, and that is the thread of opposition between an ethical idea of utility, and a non-ethical concept of exchange value. From the beginning of economic thought, consciously or unconsciously, this opposition has been a fruitful source of dissension. Aristotle set forth the difference with great clearness, and took the utility side.[2] According to his view, there is a limit to what man needs, which constitutes the natural or proper limit to consumption. Beyond this limit, lies mere wealth-getting exchange, which has no limit and is unnatural. Overlooking the possibility of a science based upon exchange values, he decried wealth-getting "chrematistics" as being contrary to his ethical ideal.

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[1] The direct and absolute influence of the Physiocrats has never been thoroughly worked out. Their notions affected Lauderdale and a number of minor English writers, and Sismondi; and through these men, influenced still others.

[2] See above, pp. 68 f.

Some of the points of opposition which appear in the thought of those who show similar tendencies may be indicated thus:[1] —

Limited "needs"	*vs.*	Indefinite expansibility of wants.
Leisure necessary	*vs.*	Continuous striving to produce.
Consumption emphasized	*vs.*	Production emphasized.
Utility (total); "value in use" — "production for service"	*vs.*	Marginal utility; exchange value — "the price system."
General overproduction possible; underconsumption theory	*vs.*	No general overproduction possible; Say's Law.
Public-wealth (weal) point of view	*vs.*	Private-riches, entrepreneur point of view.[2]
Societism (socialism or nationalism)	*vs.*	Individualism.

It is obvious, at a glance, that the second column embraces some of the leading ideas of the Classical School; while the first contains those of several schools of dissent. With the dissentients would fall Sismondi, and, in part, Lauderdale and Malthus. And the Nationalists and the Socialists would be classed with them on this score. The line of cleavage is ethical, the dissentients one and all proceeding on ethical grounds in their criticism, setting up ideals as to the good or the natural. They stand for normative as opposed to positive economics.

The answer to such critics has ever been: You do well to point to the higher spiritual considerations, to emphasize the ethical point of view, and to dwell upon the evils of the present system; but economics as a distinct science has no *direct* connection with these things. Its point of view is non-ethical, its proper phenomena are the valuations involved in exchange, and it deals with the social and industrial order that exists at any given time, which down to the present time has made it worth while to postulate an automatic coördination of economic activities through exchange.

b. *Optimism and Pessimism.* — Generally, though not necessarily, connected with the foregoing difference in point of view has been the division between optimists and pessimists in economic thought. The division does not appear to be of the most fundamental importance, nor is it based upon pure science. A good deal depends upon the length of the period of time that is taken into consideration. But optimism or pessimism has characterized the thought of certain periods and nations.

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[1] For a more complete analysis, together with a synthesis of the two extremes of "utility economics" and "price economics," see Haney, L. H., *Value and Distribution*, 1939, pp. 472–476.

[2] See above, pp. 58 f., 381 f.

As a rule, the most immediate and obvious point of difference between optimists and pessimists is found in their views concerning the relation of public and private interests: those who believe the two run parallel or are identical are optimists or tend toward optimism; those who see opposition and clash between such interests naturally tend to take pessimistic views. Or another point of difference may be seen in the attitude of the two groups of thinkers toward the imminence of the "stationary state" of society.

To get at the bottom of these tendencies, one would have to resort to the philosophies of idealism and materialism, with the interrelated tendencies, societism (belief in group control) and individualism.

Idealists believe in the ability of man to dominate nature and put off the evil day of the stationary state; which is a comfortable belief, and *tends* toward optimism.[1] Moreover, in advocating group control through social institutions, they look to the elimination of discordant individual or private interests.

The matter is not so simple with the materialists and individualists, for they have been divided into two groups. The French school of Liberalists, for example, has apparently not departed from the idea of man's dependence upon natural environment; but, following the Physiocrats, they have regarded the rule of nature as beneficent, and so have been led to doctrines of harmony rather than pessimism. On the other hand, the English Classicists for the most part believed that nature was a niggardly jade whose one great law was that of diminishing returns. Her sway, then, they tended to regard not as beneficent, but as harsh and leading to a stationary or declining state; and hence their views were, on the whole, rather pessimistic. Adam Smith sometimes dwells upon the harmony of interests secured by interplay of private motives as guided by a divine hand, but again he emphasizes the discordant elements of society. The French followers took the system of harmony; the English could not reconcile the conflicting interests which their analysis disclosed.

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[1] This may be away from an initial *pessimism* concerning existing conditions (e.g., Keynes).

Clearly, if one assumes that man desires pleasure, and that pleasure is good, one may be an optimist. If, however, one considers man to be a creature of instinct and impulse, what then? One must either assume, inconsistently, that some men can plan and lead — and that these superior ones will be found and given power — or one must just feel optimistic or pessimistic as a matter of sentiment.

c. *Various Theories of Surplus.* — One of the most interesting threads of development in economic thought appears in the various doctrines of surplus, an obvious point of significance being the bearing of such doctrines upon questions of taxation and government interference. This thought thread could be traced in a volume; it can be but barely indicated here.

The purely economic idea of surplus is one concerning a reward in excess of the amount absolutely required to secure the coöperation of a factor of production or a unit thereof; that is, an excess over cost. Such "producers' surpluses," really a sellers' surplus, may be competitive "differentials"[1] (dependent upon either natural or artificial differences among units of a productive agency), or they may be monopolistic and acquisitive, or they may be purely fortuitous. In any case, they depend upon exchange value being above expenses during the period of time under consideration.

The Physiocrats made land the source of a great surplus, the *produit net.* The Classical economists analyzed and elaborated the idea, introducing the concepts of intensive and extensive margins, and making land rent a differential return measured from such margins. Thus rent was made a differential surplus obtained by comparing different units of land or different investments on land.

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[1] But note that a differential, under competition, is to be regarded as necessary to induce maximum output.

Some economists, however, — including some Classicists — regarded land ownership as a monopoly which might bring the landlord abnormal returns in the shape of an absolute surplus. This idea is related to the general idea of "scarcity value," and it is to be noted that any naturally scarce object may be regarded as yielding an original owner's surplus, since its existence involves no cost of production.

About the middle of the nineteenth century, the doctrine of "unearned increment" became fully developed in England (J. S. Mill), the idea being that increase in land values is largely outside the scope of individual activity, and due to society. This doctrine passes over into ethical regions.

Some tendency to regard profits (interest and entrepreneur's gains) as containing an element of surplus is manifest, — in the residual claimant idea of Ricardo, for instance, — a tendency fostered by the lack of a clear analysis of this share in distribution. Senior's abstinence theory, however, put interest upon a cost or earned basis; and the final separation of undertakers' gains and pure profits cleared the situation further. But with the Great Depression of the 1930's came Keynes's idea about interest payments as being largely unnecessary, and the notion of some Institutionalists that capital equipment is part of a "social heritage."

The extension of the differential-return analysis and "marginism" to the theory of labor and capital has tended further to broaden the idea of economic surplus.

The distinction between static and dynamic theory has also introduced an extension of the idea, since it is recognized that friction, conjuncture, and other factors give more or less temporary surpluses or "quasi-rents" from the dynamic standpoint.

More refined, but somewhat akin to the Physiocratic idea, are certain optimistic theories of more recent times (e.g., of Professor Patten). A few writers, denying the law of diminishing general returns, believe that costs decrease, and that a surplus arises on account of increasing demands. Or, to put it another way, they believe that man, gaining more control over nature, is able to produce more than enough to restore the energy he expends. This surplus would be held by producers as a monopoly return.

The use of the "dosing method" in economic analysis has caused some thinkers, beginning with von Thünen, to chase a will-o'-the-wisp surplus which seems to arise as equal units of a factor are successively applied in production with diminishing returns per unit.[1] In dealing with such a productive agency as labor, for example, some economists, although treating it as consisting of "units," consider that the historical fact of diminishing marginal productivity gives rise to a sort of differential surplus.

(It would be interesting at this point to inquire into the bearing of the "opportunity-cost" notion upon the idea of surplus. Little if any attention, however, appears to have been given to this aspect.)

Again, an ethical notion of surplus exists. Here, perhaps, would come the idea of "overproduction." Also the various notions concerning "excessive" wealth are to be mentioned. But the Socialistic idea of surplus value deserves chief attention. The surplus-value idea is most clearly expressed by Rodbertus and Marx, though it is suggested by von Thünen and Sismondi. Under capitalism, according to these writers, labor is exploited, or robbed of a part of its product, which is retained by the capitalist class as a surplus. These various notions concern an amount in excess of what is just and proper, one generally secured by unjust or improper means. The Socialistic doctrine is connected with economic analysis, but its chief bearing is an ethical one. The Keynesian ideas of capitalist enterprisers exploiting a "scarcity value" of capital that need not exist is also to be mentioned.

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[1] Cf. above, p. 370.

Another idea of surplus to find currency among Marshallian economists is of quite a different order, being psychological, and consisting in subjective value. This is the "consumers' surplus," and arises from the fact that the consumer would sometimes be willing to pay more for a utility than he is compelled to do by market conditions. An analogous "producers' surplus" may also be noted. (Probably it would be better to call these, respectively, "buyers' surplus" and "sellers' surplus.")

d. *Cost vs. Utility.* — Another fundamental difference among economic thinkers concerns the emphasis of utility in economic valuations. Aristotle began by emphasizing wants and utility, and a scattered list of thinkers such as Barbon, Galiani, and Condillac did likewise; but as man's industrial conflict with nature intensified, the costs of production loomed large and were emphasized. The Classical theories of value were cost theories, with labor cost most prominent. But a reaction came in the 1870's, and then utility was overemphasized by Jevons and the Austrians. With Marshall, a balanced combination of the two came to the front, utility and disutility being brought into a synthesis. But the faulty psychology of the old concept of utility has led many to substitute the question-begging concept of "preference" or "indifference." This tendency is increased when the economist accepts the monetary approach of "price economics" or the aggregates of macro-economics.

A concomitant development of the theory of consumption is to be noted. Slighted by the Classicists, and with its relation to production misconceived, "consumption" has taken its place as a distinct part of the modern manual of economics. Indeed, in the idealistic thought of the depression period, consumption has sometimes been put first, and underconsumption-cycle theories have appeared.

e. *Subjective and Objective Points of View.* — Following closely the preceding development has been one in the adoption of subjective and objective bases for analysis.

Perhaps the earliest tendency was subjective. But the founding of the science came with objective tendencies, and, on the whole, costs and values were regarded as objective by the Classical economists. This went hand in hand with the emphasis of cost,[1] and was especially prevalent in England. According to this way of looking at things, costs are objective facts measured in the market, being sometimes reduced to units of working time, and often identified with the expenses of the entrepreneur; and market values are objective records of demand and supply.

Then, with the emphasis of marginal utility, came the subjective tendency of Jevons and the Austrian School, and the psychology of economic values was more fully analyzed. The attempt was made to fuse utility and cost in a common subjective crucible; the objective limitations of man's physical environment were relegated to a place of secondary importance, and "estimation" was given the central place. "Subjective exchange value" was distinguished. Marginal utility was made a veritable fetish.

The subjective tendency has also been broadened by some to include real cost (disutility) as coördinate with utility, thus making choices and motivation depend upon psychic gains.

Still others, while disavowing marginal-utility subjectivism, and accepting market prices as objective data, would make economic motivation begin with and depend upon individual appraisals, — perhaps treating "opportunity" as cost to the individual. This after all seems to lead to subjective theory, unless it ignores differences in individual estimations.

Finally the Neo-Classical equilibrium thought seeks to deal with the matter by distinguishing subjective and objective value levels, emphasizing objective (market) values, but explaining their causation by means of subjective valuations of buyers and sellers. In its procedure, the Cambridge School differs from the Austrian School in recognizing cost as an independent reality, which it tends to base upon individual psychic cost, but measures in terms of money expense.

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[1] But Senior combined cost and subjective points of view.

The question still remains: Shall we attempt so to analyze motives and valuations as to find an ultimate explanation of price-determination, — of the first price, — or shall we accept the exchange values which result from the competition of the market as ultimate data? Shall we take the social or the entrepreneur point of view? (And, if the latter, is the entrepreneur to be an individual or the state?) It may be confidently predicted that any analysis of motives which minimizes the objective and environmental factors will come to be recognized as one-sided. It is equally certain that the entrepreneur's expenses will not be accepted as an ultimate datum — whether the enterprise be public or private.

On the whole, it is doubtful if economists have clearly recognized the validity and the importance of "objective" value. Regarded as a "generally recognized" value, market value may be considered not only as scientifically explainable, but as the symbol of economic democracy and coöperation. A distinction between "price" and "value" more fundamental than that based upon the use of money, would be helpful in this respect.

f. *Quantitative vs. Qualitative Values.* — No sketch of the most important — or most interesting — points in economic thought would be complete without a mention of what may be called "qualitative values." Economics as a science has been built around the idea of quantitative values, or values that can be measured. "Degrees" of utility and disutility, and amounts of sales and expenses are both quantitative concepts. Such values involve no reference to ethical appraisals of human activities and no evaluation of the goal or goals of life. But when economists undertake to determine what constitutes human welfare, and to formulate social plans which they believe contributory to such welfare, they enter a field of values which is not subject to "scientific" treatment; they undertake to deal with "qualitative values." Such values necessarily involve a joint reference to ethical, political, and æsthetic values, and the outcome seems dependent upon the intuition of the evaluator.

No little confusion and complication have resulted from the failure of some economists to make this distinction, not realizing the limitations of their special discipline. Perhaps the economist has as good a basis for such speculations as any other person, but in his normative or social-reformer capacity surely he goes beyond his capacity as an economist.

The Present Condition and Trends. — In concluding this history of economic thought it is well to inquire into the present position of some of the main doctrines and their bases, remembering that in stepping out of the rôle of historian one is confronted by the danger of hasty generalization.

The Philosophy and Method. — So much has been written about the philosophy and method of various economists of the past that one wonders what may be said about those of the present in this regard. Originally, ethical and economic considerations were intimately blended, as with the Greek philosophers, and the economic implications and involvements of the philosophies of idealism and materialism were not realized. In the nineteenth century, however, economists often tended to go to the other extreme and to cast out ethical considerations through the door of vicious abstraction, while adhering more or less consciously either to materialism or to idealism, and to correlated tendencies toward either individualism or societism.

At present, however, a conscious allowance is more often made for ethical factors in social life, so that they may not only be kept the more distinct but also have their importance more clearly recognized. Moreover, one may find some tendency to eschew the extremes of idealism or materialism and to seek the truth in a recognition of the interrelation between mind and matter, subject and object.[1] The materialism of mechanistic and behavioristic psychologies will have its vogue, but in the end will yield ground before the facts of individual character and the differences therein, merely serving to supplement our knowledge of human motives. The idealism of intuitional and volitional psychologies must similarly be recognized as inadequate.

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[1] Cf. above, pp. 19, 470 f., 498 f., 625 f.

So it is with method. While some Institutionalist empiricism remains, and a great expansion of abstract mathematical technique has occurred, the old war of methods is over. Each economist now uses in peace the method proper to himself and his particular theme, — save only that abstractions are more consciously entered upon, and the premises for deductions are usually more carefully stated. In a word, on the score of method, economists have passed from the naïve, unsophisticated stage to one of scientific self-consciousness. It may be doubted, however, that those who have chosen to live in the ivory towers of abstraction concerning human motives and costs are sufficiently aware of the gap between them and the world of reality. The revival of interest in Walrasian mathematical "solutions" of economic "problems" with the aid of "models" has also contributed to a subjectivism in economic theory to an extent which may become all the more dangerous because it is so readily applied (in the monetary "macro-economics") as a basis for policy.

One exception appears noteworthy, and even in this case the question is already understood. This exception is the problem of hedonism and the pleasure-and-pain calculus. Except on a very abstract and therefore unreal basis, it will be agreed that such a calculus can hardly serve as a foundation for economic analysis; yet without it, the confusion of numerous motives makes one hesitate to formulate principles. Few if any hold to hedonism as an explanation of the actual or concrete; but many choose deliberately and avowedly to abstract other than rational motives, making economics ("pure" economics) an hypothetical science.

Scope of Economics. — Considerable doubt exists as to what is the truest and most practicable course, a doubt which seems to lead to the establishment of different levels of economic analysis, and perhaps of different branches or departments of economics. Such classifications as Pure and Applied, Static and

Dynamic,[1] or Positive and Normative illustrate this idea. That there is danger in such separation and abstraction, history amply attests; but surely, with the long struggle between the Classical and Historical Schools before him, the twentieth-century economist may avoid the rock and whirlpool which wrecked the logic of his predecessors.

In fact, as one looks back over the course of economic thought, one can see some tendency toward general, "pure" economics. The Classicists (Ricardo, Senior) tended in that direction; but with Mill and the Historical School all manner of sociological and ethical data were embraced. More recently, a mass of technical data from the "natural sciences" and business organization has been exploited, while psychological and philosophical materials have been drawn upon. For a time, in the 1920's, it seemed that sociology might become a fairly distinct discipline; ethics might be enriched by economic infusions and gain in the exactness of its valuations; while such subjects as economic geology, economic zoölogy, economics of agriculture, business economics, and the like, might take over the "applications" of economic theory, thus helping to keep economic science separate from policy. "Politics" or "government," too, seemed to grow in importance and distinctness. Thus, by clearing economics of related but separate motives and "sanctions," and relieving it of a sort of duty to cover related phenomena, the way was prepared for a pure economics which might have been well rounded and at the same time distinct and closely coördinated.

But with the coming of war and the booms and depressions that accompany war, such a development was checked, and a reverse tendency has become apparent. By 1930, what may be called political values had come to determine ends more largely. Economics, while seeming to retain its importance, fell back to a position as the servant of political expediency — policy. And as the power (or existence) of states became the main question, a recrudescence of Mercantilism appeared. Value theory became submerged in price policy. Money and taxation became tools of the politician, and economics became "political arithmetic." This is largely the significance of Keynes.

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[1] Kinematics might be adopted as an expressive term for the mathematical "price economics."

Capital and Interest. — Among the various subjects in economic theory, capital and interest may be said to have held the center of attention. Here the primary necessity seems to be to attain a final understanding as to the nature of capital, which point has been the center of several controversies. Is capital an abstract mobile fund?[1] Is it the aggregate of concrete capital goods? If the former, any concrete good in which the fund may be embodied, including land, may be regarded as a capital good, and a tendency to slight the consideration of cost and supply of concrete goods follows.[2] But if capital be regarded as consisting of concrete producers' goods, costs come to the front, and the peculiar significance of land rent clearly appears. The latter view was held by the Classical economists. The former arose as a result of the subjective way of looking at things and the emphasis of utility, the mathematical subjectivism of the general-equilibrium school being the more influential since 1940.

The financing of war and plans for relieving depression, has had a tendency to emphasize problems of money and credit, while at the same time supplies of capital goods temporarily seemed ample. Thus, in the 1940's, there was a widespread tendency to treat capital as credit, and interest as any payment for loanable funds. The technological significance of the "capital good" thus came to be overlooked by many economists, with the result that we find the old tendencies (1) to forget the importance of the time factor as seen in the difference between fixed and circulating capital, and (2) to mix "enterprise" with capital (the equities of many small investors in the earning assets of a corporation). These tendencies constitute weaknesses in Keynes's theory much as they did in Ricardo's.[1]

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[1] Of course, if this fund is thought of as a fund of values, the question of interest determination is begged, — value of capital depends upon interest.

[2] As a matter of fact, the cost and supply of the concrete good, even when considered merely as an embodying medium, is significant.

Accordingly, further analysis has been brought to bear on interest. While some theorists cling to the significance of the costs of saving and waiting, others attribute interest to the superior productivity of roundabout methods, and still others emphasize the difference in estimation of present and future goods, making interest an *agio*. But the mathematical subjectivist, not being interested in causes, sees in interest nothing but a payment for liquidity preference. Will it not eventually appear that elements of truth are to be found in all these theories of interest? The *agio* and cost theories may be regarded as complementary, and both are supplemented by the roundabout-process theory. Liquidity preference may play a part in investment much like the reciprocal of waiting cost.

In any case, it is clear that capital no longer occupies the place of independent importance that once it held. For one thing, the entrepreneur (public or private!) has clearly ousted the capitalist from active participation in industry; and again, organization is being spoken of as a factor. Capital is regarded as a "secondary" factor assisting labor and physical environment under the influence of the social environment. Economists no longer regard it as that which determines employment and wages. Man (and his desires and aversions), together with the physical environment, are the primary factors.

Profits. — Perhaps the theory of profits, as distinguished from interest, is in the least satisfactory condition, although history shows considerable progress.[2] The undertakers' gain has been separated from rent and interest, and, more recently, from wages, — ordinary contract wages, at least. Thus, considered as a total, the scope of profits has been narrowed and made more definite. Much has been accomplished toward an understanding of the factors which give rise to such a "share" in distribution. But, as yet, no one consistent theory for the determination of this share has become generally accepted.

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[1] Cf. above, pp. 288–289, 749n., 758.

[2] See Haney, L. H., *Value and Distribution* (1939), pp. 625–639 for a complete classification of profit theories. Cf. Ghosh, P. C., *The Theory of Profits*, Calcutta, 1933.

Excluding "exploitation," three chief theories are advanced: one, the "risk theory," makes profits the result of uncertainty, which is an old idea with a new and more exact significance. A second regards profits as a reward, not for risk, but for such services as coördinating the factors of production and making business plans and organization. (According to the latter theory, the net risk is borne by capitalists.) A third kind of profit theory might be called the "changes theory." It would attribute profits to unexpected changes in prices, inventions, etc. The subjectivists, mathematical and other, who favor the "changes theory" have tended to regard profits as a share in distribution which cannot, or need not, exist either under static conditions or under perfect competition. This attitude toward the problems of pricing or value, and of attaining the most productive proportion among the factors of production, fits in with any tendency toward a "managed economy" (public enterprise!). If enterprise needs no reward except under monopolistic or disturbed conditions, why not let government control remove the necessity for profits? And if the private enterpriser himself causes the "dynamic" condition which alone gives rise to profits, why not substitute public enterprise?

The tendency to distinguish static and dynamic economic fields should help toward a clearer understanding of profits proper. Most thinkers agree that under fluctuating conditions the total income commonly known as profits is greater than under an assumption of stable conditions. Surely, however, it does not follow that profits tend to disappear. May it not be that "enterprise" (organization and direction) is required to maintain any worthwhile economic condition, whether static or dynamic? Isn't the only question, then, do men desire public or private enterprise?

Scepticism concerning enterprise and profits is reinforced by the existing confusion among enterprise, capital, and management, particularly notable in the business corporation today.

Exactly where does the ultimate responsible decision lie? Exactly who bears the ultimate non-insurable hazard of the business? In practice, are the two the same? In fixing wartime prices, too, there appeared a tendency to make lower prices for the low-cost and more efficient producers, thus reducing their profit differentials. This tendency seems to rest upon the idea that such differential profits do not reward a necessary cost of production, and that to reduce them does not reduce motivation of enterprise to produce. Thus Economics seems to be in need of a Ricardo who will demonstrate the significance of the marginal use of enterprise somewhat as the great Classical economist did for land.

Time was when an imperfect analysis left much of distribution in the residuum. With Ricardo, for example, interest and profits were the residual claimants. Now the left-over share has been reduced to profits, and parts even of that residuum may be positively explained, that is, may be reckoned as required by costs of production, or as rewards for definite productive contributions. Just as interest and profits are now less frequently confused by the economist, the time may come when the content of the pure-profits residuum will be reduced, leaving "unexplained" perhaps a minimum element of chance gains arising from unforseeable and purely fortuitous circumstances. In order to obtain this result, it may be necessary to distinguish a new "share" in distribution.

Value. — One of the clearest evidences of the current tendency appears in recent developments in the treatment of marginal utility in relation to value. The marginal-utility mist has been cleared away. That marginal utility is only an individual estimation not yet translated into market price, that it is in part an expression of scarcity and cost, and that it needs to be supplemented by subjective values, — all these things are now pretty generally realized. We no longer regard it as an ultimate touchstone for the solution of value questions.

But at the same time, and by the same token, a widely prevalent tendency is to abandon both the concept of marginal utility and the concept of economic value itself, in their place putting, respectively, the concepts of marginal indifference ("margin of substitution") and the price ratio. This, as Hicks has said,[1] may free the state from the shackles of utilitarianism; but does it not merely impose the shackles of authoritarianism? And at the end of the road toward any general equilibrium, do we not find — as did Pareto — the same problem of measuring utility as some sort of an aggregate communal quantity of want satisfaction or total "welfare"?

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[1] *Economica*, 1934.

CHAPTER XLVI

THE LIGHT OF THE PAST: CONCLUSION

At the close of this long survey of the development of economic theory, it is not unnatural to ask: Where are we and whither are we tending? A few very broad generalizations concerning the present and near future of economics may with some hesitation be hazarded. It would ill befit an account so full of recorded errors to venture upon dogmatic predictions, and what is here written is but tentative, to be interpreted in the light of the time by some future historian.

The Great Cycle in Economic Thought. — The foregoing résumé suggests a broad cyclical tendency in economic thought. (1) Beginning with Divine law and authority, there came, in the sixteenth century, the reaction of the Renaissance and Humanism. (2) Then naturalism became predominant in the Classicism of the eighteenth and early nineteenth century, only to be followed by the double reaction of Romanticism and Historicism. (3) Finally, the evolutionary-equilibrium school of Neo-Classicism emerged about 1890; and this in turn has brought on the "Institutional" and the "Universalist" or Neo-Romantic reactions—to say nothing of "new welfare" economics.

Thus we find at least three great cycles based on man's quest for standards and laws, and man's tendency to revolt against the standards and laws which he finds! Will this cycle not repeat itself? If so, does a new development of Classicism not lie ahead?

To recall the various stages through which the development of economic thought has passed will serve to throw light upon the present condition of economics.

Back in the sixteenth and seventeenth centuries, Mercantilism held sway, and the thought of the time was characterized by a belief in paternalism, and in the conflicting interests of political states. Each state was regarded as built up in a mechanical way of separate individuals, whose interests clashed with those of the state. The hand of each nation was raised against all other nations.

In reaction from Mercantilism came Classicism, which put *laissez faire* in place of paternalism; and cosmopolitanism in theory in the place of conflict among states. The welfare of the individual and of the state was generally regarded as identical, or nearly so.

In opposition to Classicism, Socialism and Nationalism arose, and the beginning of the Historical School.

Then came Neo-Classicism, which softened each one of the main doctrines of Classicism, and recognized a considerable number of exceptions. Especially was the marginal and rent analysis broadened, and the concept of society was somewhat perfected. The Austrian School is essentially Neo-Classical.

Now the world is witnessing a recrudescence of Mercantilism, which in several respects may be considered a reaction against Neo-Classicism. Paternalism is rampant; individuals are set sharply over against their governments; nationalism is the watchword of the hour. Even the economic doctrines of the Mercantilist are ascendant, such as mercantilistic ideas about money and the balance of trade. The trading companies of the sixteenth and seventeenth centuries are finding their duplicates in corporations encouraged by governments to develop export trade; associations of businessmen in each industry are paralleling the gilds; and labor organizations are also taking on more and more of gild-like character.

The Future: No Revolution. — How long this stage will last, no one can say. But one who looks at things from the point of view of history, especially if one be reasonably optimistic, can well predict that this is but an experimental stage in the great laboratory of time from which in the end will come a new Neo-Classicism much less imperfect than that which arose at the beginning of the nineteenth century.

For one thing, the exigencies of the time have emphasized the need of statistics — of "political arithmetic"; and if, by the perfection of statistical measurement, the science of economics is enabled to take on a more exact character, a great step will have been taken in advance. Surely all economists have regretted the lack of quantitative analysis.

Again there has been a great education in common consciousness; or perhaps it would be better to say in conscious commonness.[1] Men have been forced to act with other men in close coöperation; they have been compelled to take a social point of view which, if now narrow and again extreme, may yet lead to a truer understanding of economic life. Economists have been forced to come to the front and deal with the practical issues of the state, and to help save the life of the nation (and of other interrelated nations) in such a way as is bound eventually to affect economics for the better.

The author does not see in what has taken place, or is likely to transpire in the near future, anything which constitutes a revolution in economics.[2] Some have thought that the war and post-war nationalism will scrap a large part of the science. It seems more likely, however, that it will but prove the soundness of many "old" theories. The law of supply and demand cannot be abrogated, and is not abrogated by a better understanding of demand or the element of purchasing power. The theories of international trade, of money, value, rent, diminishing returns, and many others, have been useful in a practical way, and have been strengthened rather than disproved. Surely it is a notable fact that so many recent studies of international trade appear to lead to substantially the same conclusions reached by the Classical economics.

With greater statistical knowledge, and with a truer social point of view, we will some day revolt from or develop out of Mercantilism. The day of cosmopolitanism is far off, but perhaps not much farther than were the days of Machiavelli, Henry VIII, or Colbert.

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[1] See Haney, "The Social Point of View in Economics," *Quart. Jr. of Econ.* Vol. XXVIII (1913-1914).

[2] Those who follow Keynes (not their own radical ideas of Keynes's meaning) do not seek a "revolution."

The Individual, Society, and the State. — By 1930, and for a generation thereafter, large and active groups of economists came to assume the desirability of government intervention — to assume the desirability, if not the necessity, of a managed economy. As war and depression brought disequilibrium, both political and economic, and society seemed to break down into pressure groups, confidence in individual initiative and competition waned. So many economists swung to the extreme position of assuming as a general truth that the state *should* intervene. The "goodness" of government intervention has become a concealed postulate of much economic theory. This condition may be regarded as a corrective reaction from the opposite extreme of assuming the "goodness" of private initiative and the desirability of non-intervention.

Furthermore, the emphasis came to be laid upon the monopoly elements in economic life, and this tendency led to or reinforced the tendency to apply the principle of monopoly to the central control over individual parts of the economy. Thus the concept of "optimum" as an individual monopolist's maximum net return was mixed with the concept of the "optimum" as an allocation of the total "resources of society" or mankind designed to give the maximum of want gratification or welfare to all.

This procedure may have been *necessary* when one group was attacked by another, and regimentation was *required* to enable the individual to survive as a part of a group. It provided a framework for economic life, protecting the individual from external aggression and, perhaps, from aggression by other members of his own group. But it allowed for little if any freedom of individual choice, and provided no basis for objective economic value. It allows no criterion either of the full utilization of *all* resources or of the maximum gratification of *all* individual wants.

It is well to have reminded cosmopolitan thinkers that nations are important real phenomena, and that as long as one nation stands opposed to another, macro-economic problems exist. Individualists and materialists had to learn that the "framework" of social institutions is an important independent variable, and that problems of social control or regulation must be confronted.

But it now seems that in important respects, the corrective reaction has swung too far. Certain groups of questions suggest this conclusion: (1) In the end, which group is to survive, if any, and why?[1] Which is "better" for the individual — to which shall he flee? (2) Which social "framework" is best? Which allows the activities that lead to the maximization of "well-being"? How are we to ascertain? Can economics give the answer? (3) How is the best use of a given framework to be attained? Within each institutional framework is a mass of different individuals. How are their activities to be motivated and directed?

The probable final outcome is that there will come to be recognized more clearly an art of social management (statesmanship?) distinct from the science of economics. Economic science exists within any given social structure or framework. It is objective, dealing with the means of attaining such ends as are determined by the individuals within the social framework. It is coördinate with ethics and politics. But social management, or statesmanship, concerns the framework itself — the policy of control. It is subjective, and deals with "ends." It combines economics, ethics and politics, for the purpose of regulating the economy. This gives rise to so-called social values. It may be found to be the true field of macro-economics.

Once stable socio-national frameworks are established, and "order" prevails within and without, it is likely to be found (again!) that within each social order the labor and other resources may be allocated best by the forces of free markets, except that in certain definite monopoly areas regulations based upon competitive analysis will be adopted. One trouble today is that the two things, science of economics and art of social management, are being mixed. We start with a political policy, and mix up economic, ethical, and political values so that no definite appraisal is possible.

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[1] Is it better for the individual to suffer as a member of a nation (in the army) or as a member of a family (in business competition)?

Certainly the economist, as such, can hardly consider himself to be the source of all social wisdom.

That there is hope for such a development is apparent in the more objective consideration now accorded by all economists to the subject of collectivism. It is now generally recognized (1) that a system of collectivism can be made to work, and (2) that such a system must be given serious thought. Thus, in the last analysis, the question is, Which do men desire, the framework of collectivism or the framework of individualism? Which do individuals desire, a social arrangement centered on "security" or one centered on "freedom"? And the answer, it seems, is one that requires experiment. Those who are immediately convinced by theoretical analysis and historical study that one or the other is better, must await the slower decision of those who want to "try and see."

Meanwhile, the economic scientist if he is to retain influence must either remain neutral, or must do as here suggested — seek to determine objectively the fields in which politico-social action is best and those in which direct free individual choice is best, thus allowing places both for social planning and macro-economics and for objective market value and micro-economics.

Few, indeed, are those economists who now deny that considerable regulation of competition is required. The question is one of standards, and may be said to be one of *whose* standards. Thus the one peak of truth which towers above all others, as one looks back over the difficult mountain trail through which economic thought has come down to us, is the necessity of some standard which is *objective in the sense that it represents voluntary agreement* among individuals. The immediate question may be: What regulation is best? Or it may be: How know when the optimum well-being is attained? Whatever it is, the criterion for a *true* answer is related to individual desires, instinctive, emotional, reflective. Even the old Mercantilists (e.g., Steuart) relied upon individual self-interest.

In this connection, the great importance of international trade in connection with the development of economic thought is to be noted. When international stability is restored, so that there is sufficient freedom of exchange among nations to allow a return to some standard of price measurement, then economic and political values will become sufficiently disentangled to allow such a development of the science of economics as occurred prior to the World Wars of the twentieth century.

Price Economics vs. Value Economics. — As has been pointed out in preceding pages, the Classical economics sought objectivity of measurement by treating "costs" as prices paid for factor services. The Austrian School resorted to utility-cost, making one object foregone the cost of another. This essentially circular treatment, Marshall, after apparently attempting to escape by means of his subjectively-based "supply prices" and "demand prices," perpetuated, by his treatment of money as having marginal utility, his setting up a sales curve as unity of elasticity in demand, and his resort to opportunity cost. It may be said, however, to have at least left ajar the door to a more fundamental analysis of value determination.

Certainly, in the Neo-Classical system, price economics developed to a point where one of two things had to happen:

(1) Economics could have gone ahead along the path *suggested* by Marshall, taking psychology and technology as two independent variables — human desires and goods. From psychology, the economist could have taken his analysis of positive and negative desires, as motor tendencies on which to base significant concepts of utility, disutility, and subjective value. From technology, he could have taken his analysis of environmental limitations, and classification of factors of production.

(2) Or economics could have done exactly what seems to have been the main tendency since Marshall's death; namely have gone back to the circular-flow scheme of the Physiocrats and

Mercantilists, assuming that *le prix fait tout* — that prices are everything, that exchange ratios between or among goods are basic data, and that money is just another good, the value of which may be either taken for granted or neglected.

The first course would lead to "value economics," with the determination of value considered as dependent upon causal forces — the primary *conditions* of supply and demand.

The second course, however, has been adopted by policy-minded economists serving the debt-ridden war economies of the period of World Wars, or seeking an escape from the realities of differences among men and limitations of environment. This way has been highly developed by keen mathematical minds, in the form of "general equilibrium" systems and "new welfare economics." Men have taken the easy way, somewhat as John Law sought to provide an escape for Louis XV.

One may say that the circular-flow price-economics will have its vogue, at least as long as managed currencies and Nationalism prevail.

The Present: Economic Science Stands. — Today, though debate rages on all sides, the dominant note is one of better understanding. Nationalists are less narrow; Socialists are revisionistic; the historical group is less negative and more tolerant of deduction; the Austrians and Neo-Classicists, more careful in recognizing variety of motive and relativity of theory. "Monopolistic competition" may be taken in as supplementing theory based primarily on competition. The macro-economic models seem likely to be of use in budgeting and general business forecasting. And Institutionalism plays the useful part of criticizing abstract generalizations.

Economists are realizing the interrelation of things; more and more the quest for absolute laws of causation is modified by a knowledge that, while some things are primary and others secondary, changing economic phenomena react upon one another, as do supply, demand, and price. "Dynamic" forces tend toward "static" equilibria, which, however, may change through evolution — or, perhaps, through revolution. But is it not beginning to be realized that the economist must find at the end of his mathematical equations exactly what he put into them at the beginning, perhaps by way of assumption; and that the negative concept of "indifference"[1] is meaningless except in relation to the positive concept of utility as desire tendency?

It seems likely that as the various schools develop their several doctrines, the eternal question, *why*, will arise, and the fundamental nature of the individual human being will emerge. Then it will appear that the central body of economic principles has grown in amount and in unity. At least, inconsistencies are more clearly seen, and differences are better understood.

Now, as ever, policies and programs are at issue, but as these rise and fall the science stands.

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[1] One feature of much recent economic thought is the tendency to define concepts in negative terms, which involves something of a mathematical method. Thus not only is a "preference" merely a *not*-choosing the other good; but also, "saving" is *not*-spending, "liquidity preference" is *not*-investing, and "pure competition" is *not*-monopolying.

APPENDIX

CHIEF WORKS OF AMERICAN ECONOMISTS ACTIVE BETWEEN 1850 AND 1915[1]

List of the chief economic works of those American Economists (mostly mentioned in Chapter XLIV) who were active between 1850 and 1915.[1] This is not intended to be a summary of current literature, but a record of the chief work of those who have either passed on, or who have attained such maturity that their work may be supposed to show some semblance of final shape.

ADAMS, H. C., *Taxation in the United States, 1789–1816* (1884).
  Public Debts (1887).
  Relation of the State to Industrial Action, A.E.A. (1887).
  Economics and Jurisprudence, A.E.A. (1891).
  Science of Finance (1898).
  American Railway Accounting, a Commentary (1918).
  Description of Industry — An Introduction to Economics (1918).
  "Problems of Budgetary Reform," *Jr. Pol. Econ.* (1919).
ADAMS, T. S., *Taxation in Maryland* (1900).
  Labor Problems, joint author with H. L. Sumner (1905).
  Mortgage Taxation (1907).
  Outlines of Economics, jointly with Ely and others (1908 and later editions to 1937).
  The Effect of Income and Inheritance Taxes on the Distribution of Wealth, A.E.A. (1915).
ANDERSON, B. M., *Social Value* (1911).
  The Value of Money (1917).
  Effects of the War on Money, Credit and Banking in France and the United States (1919).
  Numerous articles on Money and Banking in *Chase Economic Bulletin* (1920–1936).
  "The Road Back to Full Employment," in *Financing American Prosperity*, Twentieth Century Fund, 1945.
ANDREWS, E. B., *Institutes of Economics* (1889).

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[1] Titles in italics are books or monographs. A.E.A. indicates American Economic Association publication; *Q.J.E.*, *Quarterly Journal of Economics*. The list is the same as in earlier editions, the bibliographies being enlarged in a few cases as required by later work done.

Atkinson, E. A., *Report on Bimetallism in Europe* (1887).
The Science of Nutrition (1896).

Barnett, G. E., *State Banking in the United States* (1902).
Studies in American Trade Unionism, co-editor (1906).
The Printers (1909).
State Banks and Trusts Companies (1911).
Mediation, Investigation, and Arbitration in Industrial Disputes, with D. A. McCabe (1916).
Machinery and Labor (1926).

Bascom, J., *Political Economy* (1859).

Bemis, E. W., *Coöperation in New England*, A.E.A. (1886).
Municipal Ownership of Gas Works in the United States, A.E.A. (1891).
Municipal Monopolies (1889).

Bolles, A. S., *Industrial History of the United States* (1878).
Financial History of the United States (1879–1886).
Practical Banking (6th ed., 1889).

Brown, H. G., "Competitive and Monopolistic Price Making," *Q.J.E.* (1908).
"The Marginal Productivity versus the Impatience Theory of Interest," *Q.J.E.* (1913).
The Discount versus the Cost-of-Production Theory of Capital Valuation, A.E.A. (1914).
International Trade and Exchange (1914).
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Revue d'histoire des doctrines économiques et sociales (discontinued).

Palgrave, *Dictionary of Political Economy.*

Conrad, Elster, *et al., Handwörterbuch der Staatswissenschaft.*

Seligman, *et al., The Encyclopedia of the Social Sciences.*

Chamberlin, E., *Monopolistic Competition,* contains a notable bibliography of works on monopoly, competition, duopoly, etc. in most languages.

Harris, S. E., *The New Economics,* 1947, has a good bibliography on Keynes and Keynesian economics.

Gruchy, A. G., *Modern Economic Thought,* has a fair bibliography of writings by and about Institutionalists of the Veblen-Commons-Mitchell type.

Ellis, H. S. (ed.), *A Survey of Contemporary Economics* (1948) is useful. By using the index of names, one may find in the footnotes recent articles by many living economists, mostly American and British and mostly on the phases of economics prevalent since 1936. (Hardly any French, German, or Italian material, and little attention to any classical or neo-classical thought.)

Dubois' *Précis*, down to 1903, has fairly complete lists of books and articles dealing with different writers and phases of the history of economic thought, drawn from all the principal languages. The *Revue* *d'histoire* is a periodical (now discontinued) devoted to the history of economic thought. Besides its valuable articles, it contains bibliographical material. These two French publications are valuable bibliographical aids. Mombert's bibliographies are extensive. Cossa's well-known *Introduction* hardly needs mention. It is a mine of information, but only covers the years down to 1890. Oncken's work has a valuable classified list of authorities, but as the first volume alone has appeared, it only covers the period through the Physiocrats. As a brief sketch of the main steps in the development of economic thought, together with a statement of the leading sources, the *Grundriss* of Philippovich and the *Nationalökonomie* of Diehl, are serviceable. Knies' *Politische Ökonomie*, Cauwès' *Cours* and M'Culloch's *Literature* are older and of less value. To the various articles on authors, etc., in Palgrave's *Dictionary*, the *Handwörterbuch* and in the *Encyclopedia of the Social Sciences*, will be found appended lists of the authors' works and sources on the subject. The lists of authors' publications in the *Handwörterbuch* are generally but not always complete and very valuable.

LEADING WORKS ON THE HISTORY OF ECONOMIC THOUGHT

No attempt will be made to present a complete critical bibliography. The chief bibliographical sources have been indicated; and, in the footnotes, the most important references will generally be found in direct connection with the topic in interest. There follow, then, a few critical notes concerning the most valuable and available works, and a list of other general treatises.

BONAR, J., *Philosophy and Political Economy in Some of Their Historical Relations*, 1893 (2d ed., 1909).

This is the only attempt to "present a view of the relations of philosophy and economics through the whole of their history." Begins with Plato and runs through Marx and Darwin. Such writers as Bodin, Grotius, Harrington, Hobbes, Locke, Kant, Fichte, and Hegel, are included, along with the more prominent economists. The thought is not always clear, but the work is valuable, and the second edition has useful bibliographical notes.

BOUCKE, O. F., *The Development of Economics: 1750–1900*, 1921.

This little book is valuable for its analysis of the philosophical background for interrelations among the principles of Naturalism, Utilitarianism, Historism, and Marginism, as found in economic thought.

BOUSQUET, G. H., *Essai sur l'évolution de la pensée économique*, 1927.

CANNAN, E., *A History of the Theories of Production and Distribution in English Political Economy from 1776 to 1848*, 1893 (3d ed., 1917).,

This acute work is more special and detailed than most of the others to be referred to, as is indicated by its title. It is a detailed critical analysis of the economics of the Classicists. Considerable attention is given to the formal side: the sub-division of the science and the definition of the terms. A confusion among different concepts of distribution is indicated. At points the author is hypercritical. Cannan has also written *A Review of Economic Theory*, 1929, criticizing Classical economists' doctrines and expounding his own doctrines.

COSSA, L., *Guida allo studio dell' economica politica*, 1876. English translation, *Introduction to the Study of Political Economy*, 1892.

This classic work gives a running account of economic writers and their works, being remarkably complete from the Middle Ages to 1890. The treatment of important writers is too brief, and so many are mentioned in so small a compass that proper subordination is impossible, but the criticisms are clear, pointed, and, on the whole, just. It might be called an encyclopedia of economic literature. It is written from the point of view of a Classical economist.

DAVENPORT, H. J., *Value and Distribution, a Critical and Constructive Study*, 1908.

In spite of its title, the book is chiefly critical. It deals mostly with recent theory, and is concerned with the pure theory of distribution. There are chapters on Smith, Ricardo, Senior, Mill, Cairnes, Say, Marshall, Hobson, Clark, and the Austrians. No attempt is made, however, to treat the development of economic thought as an evolution or to associate it with environmental conditions. It is not clear, and is difficult reading, but is very valuable for advanced students.

GIDE, C., RIST, C., *Histoire des doctrines économiques depuis les Physiocrates jusqu'à nos jours* (History of Economic Theories from the Physiocrats to Our Own Time), 1909. English translation (1915. Revised ed. 1948).

This work has many excellent features. It deals with the founders, their adversaries, liberalism, the dissenters, and recent theories. Out of 765 pages, 343 are devoted to Socialism and social reform, and 44 more are given to Sismondi. Aside from the Socialists, List is the only German given chief attention. The book is well written, and the account of recent theories is enlightening.

GONNARD, R., *Histoire des doctrines économiques*, 1921 (5th ed., 1946).

GRAY, A., *The Development of Economic Doctrine*, 1933.

A good brief analytic survey of economic thought from the Greeks through the Austrian School, clearly expressed and without bias. A minor defect in balance and emphasis is found, for example, in the treatment of minor Mercantilists and of Auguste Walras (but not Léon Walras). The names, Cantillon and utilitarianism do not appear in the index, and Bentham is but mentioned.

GRUCHY, A. G., *Modern Economic Thought; the American Contribution*, 1947.

A book about Institutionalism and Institutionalists as seen by one Institutionalist. Good bibliography.

HEIMANN, E., *History of Economic Doctrines*, 1945.

Short; but not easy reading; emphasizes German literature, cycle theory, and idea of "circular flow." Hicks not even mentioned.

HOMAN, P. T., *Contemporary Economic Thought*, 1928.

While this is not a history of economic thought, its analysis of the theories of J. B. Clark, Veblen, Marshall, Hobson, and Mitchell is valuable, and deals with background and interrelations. The book concludes with a suggestive appraisal of recent trends, in American and English thought.

HONEGGER, H., *Die volkswirtschaftlichen Gedankenströmungen. Systeme und Theorien der Gegenwart*, 1925.

INGRAM, J. K., *A History of Political Economy*, 1888.

This English work covers about the same period as Cossa's history, but more space is given to ancient thought. The aim of the book is not to give so exhaustive an account of the literature, and a better balancing of material is the result. It is written from the point of view of the Historical School, and the author's criticism of Classical methods and theories is not free from bias. Ingram was an ardent adherent to Comte's ideas, and thought that economics could not be a science except as a part of sociology. The criticism of the Classical economists, the accounts of Cairnes, and of Ingram's contemporaries, Leslie and Toynbee, and the discussion of the German Historical School, are noteworthy points.

KAUTZ, J., *Die geschichtliche Entwickelung der National-Oekonomik und ihrer Literatur*, 1860.

This book deals with both ancient and modern thought. It is the best of the older works, but is largely out of date, as a result of numerous special investigations. Kautz was a student of Roscher's, and wrote from the standpoint of the Historical School. *The judgments are not always free from haste, and the style is* often declamatory. Though rather ponderous and not free from

inaccuracies, the book may still be consulted with profit. There is no index.

Kleinwächter, F., *Der Entwickelungsgang der Nationalökonomischen Wissenschaft in Deutschland*, 1926.

Mombert, *Geschichte der Nationalökonomie.*

Oncken, A., *Geschichte der National Ökonomie*, 1902. (Only the "Erster Theil — die Zeit vor Adam Smith" — has appeared.)

A learned and thorough treatise, fully abreast of recent scholarship. It is given to great detail at points, especially in dealing with the Physiocrats. (Perhaps Turgot is underrated by the author.) This is the best work on the period prior to Adam Smith.

Price, L. L., *A Short History of Political Economy in England*, 1890 (4th ed., 1903).

This concise little volume begins with Adam Smith and ends with Toynbee. The attempt is made to deal mostly with the chief English thinkers, and to center attention upon their most characteristic thought. Unbiased.

Roll, E., *A History of Economic Thought*, 1939.

Strong Marxian bias; inadequate treatment of cycle theory.

Roscher, W., *Geschichte der Nationalökonomik in Deutschland*, 1874.

This has long been the standard work on German economic thought. It is a very detailed account, yet its substantial accuracy has rarely been questioned. The book contains valuable sidelights on the economic thought of other nations.

Schumpeter, J., *Epochen der Dogmen- und Methodengeschichte*, in part one of *Grundriss der Sozialökonomik*, 1924.

Scott, W. A., *The Development of Economics*, 1933.

An account of the development of economic principles from Mercantilism to recent times, but marred by bias, particularly in favor of the Austrian School. Contains virtually no treatment of Jevons or Walras, and criticizes Marshall on the basis of his second edition. Useful summaries of the doctrines of many economists are presented, and thought concerning monetary theory is treated with relative fullness.

Spann, O., *The History of Economics*, 1930 (translated from the nineteenth German edition).

A critique of economic doctrines from the point of view of the author's "universalism." Stimulating but biased. The discussions of Physiocracy, Romanticism, von Thünen, List, and the theory of money seem most useful.

Suranyi-Unger, T., *Economics in the Twentieth Century — The History of Its International Development*, 1931. (Translated from the German, originally published at Jena, 1926.)

A valuable account of recent economic thinkers and trends in Europe and America. Unbiased. Philosophical points of view are stressed, and Part I, "Philosophical Sources of the Most Recent Economic Tendencies" is especially valuable. The attempt to classify and appraise some thousand recent economists leads to a mixture of inconsequential writers with the more important thinkers.

SURANYI-UNGER, T., *Geschichte der Wirtschaftsphilosophie*, 1931.

WHITTAKER, E., *A History of Economic Ideas*, 1940. Topical treatment of history, as opposed to chronological. A sociological point of view. Some important omissions; but useful.

Die Entwickelung der deutschen Volkswirtschaftslehre im neunzehnten Jahrhundert, 1908. (The development of German economic theory in the nineteenth century.)

This two-volume work consists of a number of essays, mostly by German scholars, and was published in honor of Professor Schmoller's seventieth birthday. The history of the theories of production, distribution, value, rent, wages, interest, population, etc., and of various practical policies, is treated in separate articles by such specialists as Lexis, Diehl, Inama-Sternegg, Bortkiewicz, Philippovich, etc. There is no index.

OTHER HISTORIES

Other histories of economic thought have been written, of which the following list presents the most familiar titles. The most useful ones are marked with an asterisk(*).

BEER, M., *Early British Economics*, 1938. Useful on period, Middle Ages to 1750.

BIANCHINI, L., *Scienza del ben vivere sociale e della economia degli stati*, 1845–1855.

BLANQUI, J. A., *History of Political Economy in Europe*, 1837 (American translation, 1880, from 4th ed., 1860).

*BLOCK, M., *Le progrès de la science économique depuis Adam Smith*, 1897.

BUNGE, N. C., *Literature of Political Economy*, 1900 (French translation from Russian).

COHN, G., *History of Political Economy*, 1894. (In Annals of Amer. Acad. of Pol. & Soc. Sci.; translated from *System der Nationalökonomie*, 1885.)

DAMASCHKE, A., *Geschichte der Nationalökonomie*, 1904 (3d ed., 1909).

The book is written as a "first introduction" to the subject. Of its 417 loosely printed pages, 155 are given to chapters on

Communism, The Anarchists, and Land Reform; and no mention is made of the Austrian School. Social reform, rather than economic theory, is emphasized. List's importance is stressed.

*Denis, Hector, *L'histoire des systèmes économiques et socialistes*, 1904–1907. 2 vols. Physiocrats to Wm. Thompson; several diagrams and facsimiles.

*Dubois, *Précis de l'histoire des doctrines économiques*, 1903. Vol. I, *L'époche antérieure au physiocrates.*

Dühring, E., *Kritische Geschichte der Nationalökonomie und des Socialismus*, 1871 (4th ed., 1900). Dühring was a follower of Carey. He was unduly harsh in criticizing writers to whom he was opposed.

*Eisenhart, H., *Geschichte der Nationalökonomik*, 1881; 2d ed., 1891. Ingram styles this work a "vigorous and original sketch." The writer has not found it so useful or readable as might be inferred.

*Espinas, A., *Histoire des doctrines économiques*, 1892.

Fridrichowicz, E., *Grundriss einer Geschichte der Volkswirtschaftslehre*, 1912. Of some value as a catalogue of authors; but contains inaccuracies.

*Hasbach, *Die all-gemeinen philosophischen Grundlagen der von Francois Quesnay und Adam Smith begründeten Politischen Oekonomie*, 1890; also *Untersuchungen über Adam Smith und die Entwickelung der Politischen Oekonomie*, 1891.

*Horn, J. E., *L'économie politique avant les physiocrates*, 1867.

Laspeyres, E., *Geschichte der Volkswirtschaftlichen Anschauungen der Niederländer und ihrer Litteratur zur Zeit der Republik*, 1865.

Macleod, H. D., *The History of Economics*, 1896. (The author's peculiar ideas somewhat illustrated from history. Not a history of economics.)

*M'Culloch, J. R., *The Literature of Political Economy*, 1845.

Myrdal, G., *Das Politische Element in der National-Oekonomischen Doktrinbildung*, 1932.

Nogaro, B., *Le dévelopment de la Pensée Economique*, 1944. Old French Classical approach. Little attention to collectivism or Keynes, or mathematical school, and none to monopolistic competition.

Nys, E., *Researches in the History of Economics.*

*Pirou, G., *Les Doctrines Économiques en France depuis 1870*, 1925 (2nd ed., 1934).

*Rambaud, J., *Histoire des doctrines économiques*, 1898 (2d ed., 1902).

Roscher, Wm., *Zur Geschichte der englischen Volkswirtschaftslehre*, 1851–1852.

Salin, E., *Geschichte der Volkswirthschaftslehre*, 3rd ed. 1944. Romanticist bias; hostile to "rational theory"; praises Sombart and Marx; really not a true history.

*Scheel, H. von, Article on History of Political Economy in Schönberg's *Handbuch der Politischen Oekonomie.*

Schelle, G., *L'économie politique et les économistes*, 1917. A sketch of the nature and history of economics from the point of view of French Liberalism. Much attention is given to various kinds of Socialism. Contains a chapter on Turgot.

Schüller, R., *Die klassische Nationalökonomie und ihre Gegner*, 1895.

Stigler, G. J., *Production and Distribution Theories: The Formative Period*, 1941.

*Twiss, T., *View of the Progress of Political Economy in Europe since the Sixteenth Century*, 1847.

Villeneuve-Bargemont, A. de, *Histoire de l'économie politique, ou études historiques, philosophiques et réligieuses sur l'économie politique des peuples anciens et modernes*, 1841.

Monographs and Treatises on Special Phases or Periods.

1. *Value Theory:*

From the vast field of special monographs, only a few will be mentioned. Especially noteworthy is the group of studies in the history of value theories: —

Sewall, H. R., *The Theory of Value before Adam Smith*, 1901 (American Economic Association Publication).

Zuckerkandl, R., *Zur Theorie des Preises*, 1889.

Kaulla, R., *Die geschichtliche Entwickelung der modernen Werth-theorien*, 1906; also *Theory of Just Price: A Historical and Critical Study of the Problem of Economic Value*, 1940 (translated from the German of 1936).

Rost, B., *Die Wert- und Preistheorie mit Berücksichtigung ihrer dogmengeschichtlichen Entwickelung*, 1908.

Schroeder, E. F., *The Marginal Utility Theory in the United States of America*, 1947.

Whitaker, A. C., *History and Criticism of the Labor Theory of Value in English Political Economy*, Columbia University Studies, Vol. XIX.

2. *Special Phases or Periods:*

Beer, M., *A History of British Socialism*, 2 vols., 1929.

Böhm-Bawerk, E., *Capital and Interest*, 1890. (Translated from first German ed.) Interest and value theory.

Bowley, M., *Nassau Senior and Classical Economics*, 1937.

Douglas, P. H., *The Theory of Wages*, 1934.

Ellis, H. S., *German Monetary Theory, 1905–1933*, 1934.

Estey, J. A., *Business Cycles*, 1941. (Good Historical Analysis.)

HECKSHER, E., *Mercantilism*, 2 vols., 1935.
HIGGS, H., *The Physiocrats*, 1897.
HANEY, L. H., "Classical School," in *Collier's Encyclopedia*, 1949.
HERZOG, J. S., *El Pensamiento Economico en México*, 1947.
JOHNSON, A. S., *Rent in Modern Economic Theory*, 1902. (American Econ. Ass'n publication).
JOHNSON, E. A. J., *Predecessors of Adam Smith, the Growth of British Economic Thought*, 1939.
LAIDLER, H. W., *A History of Socialist Thought*, 1928.
LAISTER, M. L. W., *Greek Economics*, 1923.
LEVY, S. L., *Nassau W. Senior, the Prophet of Modern Capitalism*, 1943.
MARGET, A. W., *The Theory of Prices*, 1938. Money.
MONROE, A. E., *Monetary Theory before Adam Smith*, 1923.
PIROU, G., *Essais sur le Corporatism*, 1942; *Les Theories de l'équilibre Economique, L. Walras et V. Pareto*, 2d ed., 1938; *L'utilite marginale de C. Menger à J. B. Clark*, 2d ed., 1938.
RIST, C., *Histoire des doctrines relative au credit*, etc., 1938.
SCHMOLLER, G., *The Mercantile System*, 1895.
SMALL, A. W., *The Cameralists*, 1909.
SOUCHON, *Les Théories économiques dans la Grèce antique*, 1898.
TAUSSIG, F. W., *Wages and Capital*, 1896 (wages theory, especially the wages-fund theory).
WAGNER, V. F., *Geshichte der Kredittheorien: eine Dogmenkritische Darstellung*, 1937.

INDEX OF NAMES

A

Adams, C. K., 883n.
Adams, H. B., 883, 883n.
Adams, H. C., 883n., 885, 902, 951.
Adams, T. S., 951.
Aftalion, 677, 678f., 853, 855, 857.
Åkerman, 792, 799n.
Albertus, Magnus, 99.
Alessio, 840, 841.
Allen, R. D. G., 787n., 872, 873.
Amonn, 727, 823, 828.
Amoroso, 842.
Anderson, B. M., 718n., 951.
Anderson, C. J., 757n.
Anderson, J., 292, 293n.
Andreae, 824.
Andrews, 883n., 951.
Ansiaux, 856.
Antonelli, 858.
Aquinas, Thomas, 10, 92, **98**, 99f., 101n., 103, 178.
Arias, 843n.
Aristotle, 5, 12, 30, **56ff.**, 77, 92, 97, 101, 107, 114, 128, 169, 238, 923, 924, 930.
Asgill, 126.
Ashley, 548, 860n., 863, 873, 875.
Atkins, 720n., 721, 722, 726.
Atkinson, 881, 952.
Augustine, St., 10.
Aupetit, 858.
Aurelius, Marcus, 77.
Auspitz, 816.
Ayres, C. E., 721, 726, 772n.

B

Baader, von, 407.
Babeuf, 425.
Bachi, 843n.
Bacon, 22, 114n.
Bagehot, 236, 506, 518, **527f.**, 863n.
Bain, 709n.
Banfield, 590, 594.
Banse, 824n.
Barbon, 123, 126, 132, 134, 136, 172n., 587, 930.
Barnett, 952.
Barone, 784, 788, 842.
Bascom, 880, 952.
Bastiat, 238, **Chap. XV**, 504, 513, **515f.**, 833, 846, 888.
Battaglia, 844.
Baudeau, 193, 196.
Baudin, 846n., 850.
Baudrillart, 848.
Baxa, 824.
Bazard, 428.
Beauregard, 848.
Bebel, 820.
Beccaria, 202n., 506, 832.
Béchaux, 850.
Bechers, 150f.
Beckhart, 736.
Beer, 971, 973.
Bemis, E. W., 883n., 952.
Benham, 873, 875.
Benini, 843n.
Bentham, 12, 234, 243, **Chap. XI**, 445f., 587, 864, 910.
Berardi, 839.
Bergson, 899n., 900.
Berkeley, 207.
Bernacer, 763n.
Bernstein, 496, 497.
Berolzheimer, 827.
Bertolini, 839, 844.
Bertrand, 698.
Besant, Annie, 497.
Besold, 150.
Bettelheim, 859.

Beveridge, W., 768, 872.
Bianchini, 971.
Biel, 92, 100, 102n.
Blackstone, 162n., 247n.
Blanc, 432f., 479, 504.
Blanqui, 142, 881, 971.
Block, 623, 848, 851, 971.
Boccardo, 839, 840, 840n.
Bochard, 854.
Bodin, 112.
Boese, 820n.
Böhm-Bawerk, 345n., 456n., **615ff.**, 629n., 633n., 659, 661, 815, 819, 837, 973.
Böhmert, 340, 818.
Boisguillebert, **173**, 175, 211.
Bolles, A. S., 881, 952.
Bonar, 233, 631, 873, 967.
Boninsegni, 842.
Borght, van der, 816.
Bornitz, 150, 164n.
Bortkiewicz, 631n.
Bosanquet, 284.
Bottai, 843n.
Boucke, 967.
Boulding, 695n.
Bourgeois, 854.
Bourguin, 853, 858.
Bousquet, 858, 967.
Bowen, 329, 877, 882, 883n.
Bowley, A. L., 872, 874.
Bowley, M., 973.
Brants, 857.
Braun, 818.
Brentano, 215, 548, 821, 852.
Bresciani-Turroni, 842, 843.
Bright, 237n., 238, 818n.
Briscoe, 126.
Brown, H. G., 952.
Brydges, 201.
Bücher, 547, 815.
Buckle, 177n., 236.
Bullock, 887, 952.
Bunge, 971.
Buoninsegni, 129n.
Buret, 401.
Buridan, 100.
Burke, 407.
Burns, 708, 718n., 897.
Burton, 952.
Büsch, 202n.
Butel-Dumont, 193.
Bye, 766n.

C

Caesari, 842.
Cairnes, 360, 575, **860f.**, 863.
Campanella, 114n.
Cannan, 266n., 267n., 870, 872, **873**, 968.
Cantillon, **174**, 176, 182, 196, 207, 211, 240, 593, 740, 783.
Capodaglio, 843.
Carey, H. C., 26, 296n., **Chap. XIV**, 337f., **419f.**, 525, 818, 833, 879.
Carl Friedrich, 202.
Carli, 843n.
Carlile, 873.
Carlisle, 631n.
Carlton, 952.
Carlyle, 862.
Carver, 677f., 694, 887, **893f.**, 953.
Cassel, 578, **602ff.**, 674, 744, 763n., 784, 790, 816, 824, 919.
Cato, 80, 86, 87.
Cauwès, 852, 853.
Chalmers, 457, 741.
Chamberlain, 874n.
Chamberlen, 126.
Chamberlin, E., **701ff.**, 711, 715, 717, 897, 901, 966.
Chamley, 858.
Champernowne, 763n.
Chapman, 869.
Charlemagne, 100.
Charles V, 112, 149.
Cherbuliez, 847.
Chevalier, 314, 359n., 518, 846.
Cheysson, 849.
Child, 118, 120, 121, 122, 133, 135f., 140, 143, 172n., 177, 194, 207, 216.
Cicero, 77, 79, 80, 82, 83, 84, 923.
Clark, J. B., 275n., 370n., 503, 623, 627n., 657, 731n., 878, 882, 883n., 885, **887ff.**, 894, 953.

Clark, J. M., 677f., 708, 708n., 718n., 721, 763n., 876n., 901, 953.
Clark, V. S., 775.
Clavell, 118.
Clay, 872.
Coase, 695n.
Cobden, 237n., 238, 818n., 846.
Cobiati, 839.
Cognetti, 835, 840.
Cohn, 821, 828, 971.
Colbert, 127, 164, 172, 173, 193.
Cole, 498, 874.
Colson, 849, 850.
Columella, 80.
Colwell, 329, 413n.
Coman, 883n.
Commons, **721**, 896, 954.
Comte, 26, 435, 459, 471, 473, 491, 532, 852, 853, 855, 866, 914.
Condillac, 193, 197, 201, 514, 587, 607, 930.
Condorcet, 193.
Conigliani, 836, 841.
Conrad, 180n., 507, 548, 814, 815, 820n., 821.
Cooley, 718.
Copeland, 708n., 901.
Copernicus, 149.
Cortney, 734n.
Cossa, E., 623, 840, 841.
Cossa, L., 54, 122, 195, 200, 545n., 814, 833, 834, 839, 968.
Courcelle-Seneuil, 848.
Cournot, 358f., 589, **697f.**, 702.
Cowles, 798.
Craig, 525, 588.
Croce, 840.
Crocker, 741.
Cromwell, 113, 142.
Culpeper, 133, 177, 194, 923.
Cunningham, 873, 875.
Cusa, von, 107.
Cusumano, 835, 840, 841.

D

Daggett, 954.
Daire, 185n., 191n.
D'Alembert, 194, 212.
Damaschke, 971.
Daniels, 954.
Daries, 15, 156ff., 165.
Darwin, 525, 725, 862.
Davanzati, 132.
Davenant, 112, 123n., 133, 134, 136, 144, 923.
Davenport, 519, 631n., **895**, 904, 954, 968.
Davis, H. T., 796n.
Dawson, 875.
Day, C., 954.
De Foville, 849.
Del Vecchio, 839, 842.
Denis, Hector, 972.
Denis, Henry, 858.
Denslow, 883n.
De Quincey, 310, 311.
Descartes, 177, 179, 197, 198.
De'Stefani, 843.
De Tracy, 359n.
De Viti, 835n.
Dewey, D. R., 883n., 954.
Dewey, J., 718.
Dewing, 954.
Dickinson, 874, 899.
Diderot, 212.
Diehl, 727, 817, 818, 818n., 823, 829.
Dieterlen, 859.
Dietzel, 631n., 817, 819.
Dike, 883n.
Dillard, 734n., 766n., 768.
Diocletian, 82.
Dithmar, 151, 156.
Divisia, 856, 858.
Dixon, F. H., 955.
Dobb, 869, 874.
Domarchi, 858.
Dorfman, 718n., 721.
Douglas, Maj., 741.
Douglas, P. H., 797, 901, 973.
Dove, 874.
Droz, 401, 437.
Dubois, 966, 972.
Dühring, 337n., 422, 818, 833, 972.
Dumont, 445.
Dunbar, 881, 882, 886, 955.
Dunoyer, 314, 337, 358f., 515, 846.

Dupont de Nemours, 179, 193, 196, 202n., 740.
Dupriez, 856.
Dupuit, 589.
Durand, 903.
Durkheim, 853.

E

Eberstadt, 819.
Eden, 244.
Edgeworth, 623, 659, 698, 784, 787, 866, **867**.
Effertz, 853.
Eichorn, 538.
Einaudi, 839.
Eisenhart, 972.
Elder, 329.
Ellis, 716n., 966, 973.
Ely, 883, 883n., 884, 887, **894**, 955.
Emery, H. C., 955.
Emminghaus, 202n., 818.
Enfantin, 428.
Engel, 821.
Engels, 486, 488n.
Engliš, 819.
Ensor, 280.
Epictetus, 77.
Epicurus, 69f.
Erasmus, 113.
Escher, 955.
Espinas, 972.
Estey, J. A., 666n., 973.
Eucken, 820.
Everett, 281, 318, 325n.

F

Fairchild, 955.
Fanno, 842, 843, 843n.
Farrer, 875.
Faucher, J., 340, 818.
Fawcett, 571, 860f.
Fechner, 582.
Feder, 824n.
Feilbogen, 207n.
Fellner, W., 666n., 747n., 763n., 765n., 902.
Fénelon, **174f.**
Ferguson, 207, 208, 210, 243.
Fernoldi, 843n.
Ferrara, **833**, 835.
Ferraris, C. F., 836, 841.
Ferri, 843n.
Ferrier, 411.
Fetter, 623, 718n., 876n., 887, **892**, 904, 956.
Fichte, 404, 405.
Fisher, 677n., 695n., 741, 750, 781, 784, 785, 787, 797, 887, **891f.**, 894, 896, 904, 919, 956.
Fitch, 764n.
Fix, 401.
Flux, 869.
Folwell, 902.
Fontigny, 858.
Forbonnais, 193, 202n.
Fornari, 684.
Forti, 835, 841.
Fortrey, 132, 134, 135, 140.
Fossati, 843n., 844.
Foster and Catchings, 680, 741, 770.
Fourier, **426f.**
Foxwell, 860f.
Franklin, 200, 260, 316.
Frederici, 843.
Frederick the Great, 143, 147.
Frederick William I, 156.
Fridrichowicz, 972.
Fried, 824n.
Frisch, 797, 797n.

G

Galiani, 201, 587, 607, 832, 930.
Galileo, 907.
Gambs, 772n.
Ganilh, 318, 383, 561.
Garnier, 314, 358, 359n.
Garve, 352.
Gasser, 98n., 151, 156n.
Gee, 177, 923.
Gelesnoff, 820.
Genovesi, 607, 832.
Gentz, 407.

George, Henry, 192n., 497, 882, 888, 956.
Gerlach, 631n., 817.
Gesell, 740, 741.
Ghosh, 937n.
Gide, C., 847, 851, 852, 853, 854, **855**, 859, 968.
Gide, P., 851.
Giffen, 873n.
Gioja, 833.
Gladden, 883n.
Gobbi, 840.
Godwin, 260f., 280, 425, 498.
Gonnard, 968.
Gossen, **590f.**, 916.
Gottl, 818.
Gottl-Ottlilienfeld, 824.
Gournay, 177, 193, 194, 195, 196, 923.
Grabski, 819.
Graham, 900, 901.
Grahame, 280.
Graslin, 201.
Gratian, 98.
Gray, 280.
Gray, A., 969.
Grayson, 796n.
Graziadei, 839, 842.
Graziani, 836, 841, 844.
Greef, de, 852.
Greeley, 329.
Greidanus, 734n., 763n.
Groat, 956.
Grosvenor, 881, 957.
Grotius, 10, 114, 129f., 196, 208.
Gruchy, 718n., 726, 966, 969.
Guyot, 849.

H

Haavelmo, 797n.
Haberler, 666n., 775, 763n., 764n., 796, 796n., 819, 898n., 901.
Hadley, 957.
Hahn, 741, 763n., 825.
Haller, von, 407.
Hamilton, Alexander, 202n., 316f., 412.
Hamilton, W. H., 718n., 726.
Hammarsjöld, 790n.
Hammond, 957.
Haney, 678n., 694n., 708n., 714n., 716n., 718n., 763n., 764n., 776n., 801n., 803n., 885n., 925n., 937n., 943n., 957, 974.
Hansen, 766n., 767, 898n., 901.
Hardy, 763n.
Harrington, 114n.
Harris, J., 207, 211.
Harris, S. E., 734n., 766n., 768, 775, 776n., 966.
Harrison, 117.
Harrod, **688f.**, 743, 767, 775, 796n., 869.
Hart, 798, 898.
Harvey, 907.
Hasbach, 207n., 549, 816, 972.
Hauser, 852.
Hawley, F. B., 895, 957.
Hawtrey, **685f.**, 741, 743, 870, 872.
Hayek, 663, 677n., **681ff.**, 687, 694, 763n., 817, 819, 873, 900.
Hazlitt, 279.
Hearn, 387.
Heckshcr, 974.
Hegel, 10, 436, 487, 537, 725, 915.
Heimann, 802, 969.
Heinrich, 824.
Held, 548, 821.
Helvetius, 12, 197, 198, 212.
Henderson, H. D., 869.
Henry IV, 173.
Henry VIII, 113.
Hermann, 165, 384, 404, **558ff.**, 813, 818.
Herrenschwand, 202n.
Herzog, 974.
Hewins, 872, 873.
Hicks, 663, 752, 768, 784, 785, **793ff.**, 800, 870, 872, 873, 898, 940.
Higgs, 195, 200n., 966, 974.
Hildebrand, 505, **541f.**, 821.
Hilferding, 820.
Hillquit, 496.
Hobbes, 11, 12, 114, 117, **130**, 135, 137, 139, 140, 197.

Hobson, 498, **675f.**, 738, 741, 745, 863, **870**, 890.
Hollander, 887, 957.
Homan, 718n., 969.
Honegger, 813n., 969.
Hooke, 383.
Hoover, C. B., 763n.
Horn, 972.
Hornig, von, 148, **151ff.**, 164n.
Hotelling, 700, 708n.
Hoxie, 957.
Hübner, O., 818.
Hufeland, 352, 355, 560, 564.
Hughes, 874.
Hull, 957.
Hume, 57, 84, 177, 196, 197, 207, 208, **209f.**, 212, 226n., 227n., 260.
Hutcheson, 57, 84, 131, 207, **208**, 209, 211, 212, 923.
Huxley, 862.
Hyndman, 496, 874.

I

Inama-Sternegg, 816.
Ingram, J. K., 91, 240, 532, 550, 882, 969.

J

Jakob, 352, 404.
James, 883, 883n., 958.
Jannaccone, 839.
Jarrold, 279.
Jaurès, 496.
Jay, 853.
Jenks, 902, 958.
Jennings, 590.
Jevons, 195, 248n., 253, 304n., 344, 346, 387, 451n., **593ff.**, 629, 672, 781, 863.
Johansson, 790n.
Johnson, A. S., 958, 974.
Johnson, E. A. J., 974.
Johnson, E. R., 958.
Johnson, J. F., 958.
Johnston, Alexander, 883n.
Jones, E., 958.
Jones, E. D., 958.
Jones, R., 298, **525f.**, 571, 727.
Jörg, 823.
Jöhr, 813n.
Juglar, 671, 855.
Justi, 151, **159f.**, 163, 202n.
Justinian, 76.

K

Kahn, 700, 743, 757n., 767, 869, 872.
Kaldor, 708, 767, 870, 872, 873, 875.
Kant, 8, 9, 10, 207n., 232, 405, 827, 864.
Kaulla, 727, 818, 973.
Kautsky, 496, 820.
Kautz, 51, 203, 545, 969.
Kemmerer, 958.
Ketteler, 823.
Keynes, J. M., 663, 664, 668, 687, 689, **Chap. XXXVII**, 781, 783, 785, 790n., 793, 794, 796, 797, 797n., 825, 844, 869, 900, 902, 924, 928; 936, 943.
King, Charles, 177.
King, W. I., 959.
Kingsley, 874.
Kinley, D., 959.
Klein, L. R., 740n., 766n., 767, 784, 797n., 798, 898, 902.
Kleinwächter, 819, 970.
Klock, 150.
Knapp, 816, 817, 821.
Knies, 22, **542f.**, 545n., 821, 888.
Knight, 763n., 896, 900, 901, **901n.**
Komorzynski, 623n.
Kondratief, 677n.
Koopmans, 797n.
Kramer, 763n.
Kraus, 352, 355.

L

Labriola, 839.
Lachmann, 800.
Laidler, 974.
Laister, 974.
Lampertico, 834, 835, 840, 841.

Landry, 631n., 853.
Lange, F. A., 337n.
Lange, O., 768, 795n., 800, 800n., 898, 899, 899f., 900, 902.
Laski, 872.
Laspeyres, 972.
Lassalle, 299, **485f.**, 503n.
Lauderdale, 243, 244, 290, 317, 318, 344, **381ff.**, 514, **555ff.**, 739, 924n.
Laufenburger, 859.
Laughlin, 887, 959.
Launhardt, 622, 623, 816.
Lautenbach, 763n.
Laveleye, 311, 548, 851, 856.
La Volpe, 842, 843n.
Law, John, **126**, 195, 668, 948.
Lederer, 689f., 741, 825f.
Leibnitz, 10.
Lenoir, 858.
Lenz, 819, 823, 824.
Leone, 839.
Leontief, 695n., 763n., 764n., 784, 796, 796n., 797, 798, 898, 901.
Le Play, 847, **848**.
Lerner, 740n., 766n., 767, 873, 899, 899f., 900.
Leroy-Beaulieu, 847, 849.
Lescure, 849, 850, 856.
Leslie, 207n., 212, 234, 340, 506, 524, **529**, 573, 727, 877.
Le Trosne, 185, 193, 196.
Levasseur, 849.
Levy, 974.
Lexis, 631n., 816.
Lieben, 816.
Liebknecht, 820.
Liefman, 819, 829, 893.
Lindahl, 662, 763n., 784, 790.
Linguet, 201.
List, 314, 324, 372, **410ff.**, 422, 525, 538, 818, 878.
Lloyd, 282, 588, 916.
Locke, 12, 131, 132, 134, 139, 172n., 177, 179, 180, 192, 197, 207, 208.
Longe, 571f.
Longfield, 588.
Loria, 631n., 836, **838**, 841.
Lösch, 796, 826.
Lotz, 352.
Lough, 960.
Louis XIV, 127, 173, 175, 177.
Louis XV, 126, 175.
Louis XVI, 175, 195.
Louis, Saint, 95n., 95.
Lowe, 318n.
Lüder, 352.
Ludlow, 874.
Luther, 113.
Lutz, 960.
Luzzatti, 835, 841.

M

Mably, 201, 425, 506.
Macaulay, 473.
MacDonald, 497.
Machiavelli, 112.
M'Culloch, 239, 256, 284, 287, 289, 310, 311, 345, 506, 560, 562, 570, 972.
MacFarlane, 960.
Machlup, 695n., 819, 901.
Macleod, 513, **516f.**, 741, 783, 972.
Macvane, 631n., 960.
Magliani, 835.
Maine, 31, 528, 862.
Malebranche, 10, 179, 198.
Malthus, 15, 160, 202n., 214, 242, 243, **Chap. XII**, 293, 297, 298, 302, 318, 321, 324, 336, 398, 457, 463, 506, 570, 669, 739, 803.
Mandeville, 207, 208, 213.
Mangoldt, von, 565, 568n.
Manley, 133f.
Manoilescu, 843n.
Mantoux, 736n., 859.
Marchal, 707n., 858.
Marget, 763n., 901, 974.
Marshall, A., 27, 205, **Chap. XXXII**, 659, **698f.**, 705, 742, 753, 762, 772, 785, 803, 830, 836, 855, 863, 865f., 869, 947.
Marshall, Mary Paley, 205, 866.
Martello, 835, 839.
Marx, 221n., 432, **486ff.**, 500, 501, 505, 581, 674f., 725, 739, 765, 820, 839, 900, 914.

Masci, 843n.
Masslow, 820.
Mataja, 623n.
Maunier, 854.
Mayer, 819.
Mayo-Smith, 960.
Mayr, von, 816.
Mazzola, 835n., 841.
Meade, E. S., 960.
Meade, J. E., 872.
Means, 721.
Meitzen, 816, 821.
Melon, 172.
Menger, 593, **608ff.**, 618, 629n., 814, 815.
Mercier de la Rivière, 178n., 181, 190, 191n., 192n., 193, 196, 200.
Mering, von, 763n., 765n.
Messedaglia, 833.
Metzler, 794n., 796n., 898.
Meyer, A., 818.
Meyer, B. H., 903, 960.
Meyer, R., 622.
Meyers, A. L., 766n.
Miaskowski, 548.
Michaelis, 818.
Mill, James, 247, **310**, 345, 443, 529, 570.
Mill, John Stuart, 12, 205, 215, 226, 234, 247, 253, 279, 306, 314, 325, 344, 387, 401, 441, **Chap. XXIII**, 511, 575, 638, 671, 672f., 861, 887, 915, 923.
Minghetti, 401.
Mirabeau, 143, 177, 185, 190, 193, 194, 196, 202n., 260.
Mises, **680f.**, 817, 819, 826, 900, 901.
Mitchell, W. C., 677n., **725**, 727, 896, 960.
Mohl, 822.
Molinari, 849.
Möller, 707n.
Mombert, 966, 970.
Money, 875.
Monroe, 974.
Montanari, 132.
Montesquieu, 174, 177, 197, 318.
Moore, H. L., 677n., 797, 887, 895, 961.
More, Sir Thomas, 114, 425.
Moret, 858.
Morgan, T., 766n.
Morgenstern, 695n., 819.
Morrelet, 193.
Morrelly, 425.
Mortara, 841.
Mosak, 796n., 798.
Möser, 54, 202n.
Moses, 54.
Mossé, 859.
Moufang, 823.
Moulton, 763n., 961.
Muhs, 828.
Müller, 404, **406ff.**, 422, 538, 731n.
Mun, 119, 121, 124, 132, 143.
Mund, 708n.
Murray, A. Roberto, 842.
Myint, 872n., 899n.
Myrdal, 662, 784, 790, 972.

N

Napolitano, 843n.
Nasse, 548, 821.
Nazzani, 834, **835**, 839, 840.
Nebenius, 352f.
Necker, 202n.
Neisser, 689, 825.
Neumann, 817, 818, 821.
Newcomb, 507, 881, 961.
Newton, 177, 907.
Neymarck, 849.
Nichol, 695n.
Nicholson, 413n., **865**.
Nickel, 828.
Niederhauser, 826.
Noel, 850.
Nogarro, 683, 850, 856, 972.
Nordhoff, 329.
North, 122, 134, 207.
Nys, 972.

O

Obrecht, 150.
Ogburn, 718n.
Ohlin, 752, 784, 790, 796, 796n., 826.

Oncken, 5, 207n., 970.
Oppenheimer, 823.
Oresme, 92.
Ortes, 392, 832.
Owen, 282, 426f.

P

Palander, 826n.
Palgrave, 691.
Pantaleoni, 518, 835n., **836**, 839, 841.
Papi, 843n.
Pareto, 659, 698, 744, 784, 785, **786f.**, 793, 801, 835, 836, **837**, 844, 940.
Passy, 849.
Patten, 329, 623, 883, 887, **890f.**, 929, 961.
Paulus, 76n., 81.
Pedius, 81.
Peel, Robert, 4n.
Pelontier, 497.
Perlman, 721.
Perreau, 850.
Perroux, 858.
Perry, A. L., 506, 518, 877, 880, 882, 961.
Persons, W. M., 677n.
Peruzzi, 835.
Pesch, 823.
Petty, 119, 121, 131, 135, 137f., 174, 207, 593, 923.
Philippovich, 622, **623**, 814, 815, 817, 819, 828.
Phillips, 318.
Pic, 853.
Pierson, 623.
Pietranera, 841n.
Pietri-Tonelli, 842n.
Pigou, 678, 679, 743, 763n., 864, **868**, 875.
Pirou, 846n., 857, 876n., 972, 974.
Pitt, 4n., 236, 237.
Place, 281.
Plato, 5, 8, 10, 30, 33, **56ff.**, 114.
Platter, 820.
Plehn, 961.
Plenge, 819.
Pliny the Elder, 77.
Pliny the Younger, 77.
Polanyi, K., 722.
Polanyi, M., 768.
Predöhl, 826n.
Price, L. L., 275n., 970.
Price, R., 260.
Prince-Smith, 339, 818.
Proudhon, **434**, 479, 504, 739.
Pufendorf, 129f., 132, 197, 208.
Pulteney, 383.
Purves, 280.

Q

Quesnay, 176, 178, 179, 180, 182n., 184n., 185, 187n., 191, 193, **194**, 195, 196, 200, 205, 207n., 212, 217, 236, 238, 318, 740, 923.
Quetelet, 847.

R

Rabbeno, 836, 840, 841.
Rae, **384ff.**, 527, 727, 739, 915.
Rambaud, 972.
Rau, 149, 163, 352, **353f.**, 355, 404, 564, 611, 813, 822.
Ravenstone, 281.
Raymond, 317f., 383, 412, 422.
Read, 296n.
Reder, 872n., 899n.
Ricardo, 205, 214, 234, 238, 243, 247, 271, 272, **Chap. XIV**, 321, 322, 324, 332, 336, 345, 365, 444, 452f., 456, 458, 484f., 494, 526, 528, 530, 570, 593, 629, 669, 696, 735, 910, 921, 923.
Ricca Salerno, **836**, 840, 841.
Ricci, 842, 843.
Richardson, 119n.
Rickart, 816, 828.
Ripley, 962.
Rist, C., 740, 857, 968, 974.
Ritschl, 826n.
Rivière, M. de la (*see* Mercier).
Robbins, L., 658n., 683, 872, 873.
Robertson, D. H., 680, 743, 744, 752, 784, **789f.**, 869.

Robertson, J. M., 741.
Robinson, J., 700, **705ff.**, 708, 717, 740n., 743, 767, 869, 874.
Rodbertus, 432, **480f.**, 488, 505, 670, 822.
Rogers, 258, 534, 873.
Roll, 970.
Rooke, 293n., 525.
Roosevelt, 719, 739, 770n.
Röpke, 820.
Roscher, 161, 162n., 409, **540f.**, 543, 813, 821, 834, 835, 855, 970, 972.
Rossi, 847.
Rost, 973.
Rousseau, 12, 178, 201, 260, 449, **506.**
Rouxel, 850.
Rowntree, 863n.
Roy, 858.
Rueff, 763n., 858, 859.
Ruhland, 819.
Rümelin, 21n.
Ruskin, 862, 870.

S

Sadler, 281.
Saint-Simon, **426f.**, 446, 504, 915.
Salin, 826n., 972.
Samter, 820.
Samuelson, 766n., 767, 794n., 802, 898, 902.
Sanborn, 883n.
Sartorius, 352, 404, 560.
Savage, 802n.
Savigny, 528, 538, 851.
Sax, 622, 623, 628, 815, 817, 836.
Say, J. B., 272, 314, 330, 332, 337, **355ff.**, 434, 445, 559, 561, 607, 669, 786, 880, 911, 923.
Say, L., 212, 411, 848.
Scaccia, 129n.
Schäffle, 545, 547f., 731n., 821, 821n., 822, 835.
Schanz, 548.
Schätz, 849.
Scheel, von, 821, 973.
Schelle, 195n., 849, 973.
Schelling, 10.
Schiattarella, 836, 840.
Schlegel, 407.
Schmalz, 149.
Schmoller, 146, **545f.**, 815, 817, 819, 821, 828, 852, 974.
Schneider, 707n.
Schönberg, 548, 821.
Schroeder, E. F., 973.
Schroeder, von, 151, 156.
Schüller, 973.
Schultz, H., 797, 887, 901.
Schulze-Delitzsch, 818.
Schumpeter, 679, 694, 763n., 775, 785, 788, 815, 816, 819, 825, 858, **898n.**, 900, 901, 970.
Schuyler, 883n.
Schüz, 545.
Schweitzer, 673n.
Scitovsky, 875.
Scott, W. A., 656, 962, 970.
Scotus, 97.
Scrope, 346.
Seager, 962.
Seckendorf, 150, 156, 164n.
Secrist, 962.
Seidler, 623n.
Seidler-Schmid, 824.
Seignobos, 852.
Seligman, 883, 883n., **894f.**, 962.
Seneca, 77, 82.
Senior, 226, 238, 239, 281, **Chap.** ~~**XVI,**~~ 452f., 502, 589, 715, 803, 835, 837, 931n.
Serra, 112.
Sewall, 973.
Shaftesbury, 177.
Shaw, 497.
Shove, 700, 869.
Sidgwick, **864.**
Simiand, 854, 855.
✓Sismondi, 15, 16, 201n., **Chap. XX,** 425, 457, 481, 482, 525, 559, 669f., 739, 783, 847, 923.
Slichter, 721, 722, 726, 730, 763n., 901.
Slutsky, 787n.
Small, 148, 165, 974.

Smart, 623, 873.
Smith, Adam, 27, 30, 57, 84, 131, 136, 139, 142, 161, 171, 196, 201, 206, **Chap. X**, 247, 251, 253, 254, 260, 273, 286, 291, 305, 308, 318, 321, 341, 351f., 357, 372, 377, 386, 408f., 414, 417, 470, 483, 509, 531, 541, 557, 558, 560, 570, 740, 747, 909, 923.
Smith, E. P., 328, 877.
Smithies, 708n., 763n., 768, 798, 898.
Snijders, 707f.
Socrates, 22, 29.
Soddy, 741.
Soden, 352.
Sombart, 816, 819, 825, 828.
Sonnenfels, 163, 259, 923.
Sorel, 497.
Souchon, 974.
Soule, 766n.
Souter, 735.
Spann, O., 404, 407, 823, **824**, 828, 829, 970.
Spence, 201, 244.
Spencer, 326, 525, 589, 840, 862, 864, 917.
Spiethoff, **673f.**, 687, 727, 819.
Spinoza, 198, 283.
Spirito, 843n.
Sprague, 677n., 963.
Sraffa, **699**, 700, 869.
Stackelberg, 701, **707**, 709n., **823**.
Stammler, 727, 827, 828.
Stein, von, 491, 504, 537, 818, 834.
Stephinger, 819.
Steuart, James, **138f.**, 207, 923, 947.
Stewart, Dugald, 243, 244, 260.
Stewart, W. W., 718n.
Stieda, 816.
Stigler, 708, 973.
Stöcker, 823, 824.
Stolzman, 727, 823, 828.
Storch, 558n.
Stourm, 849.
Strigl, 819.
Sully, 173.
Sumner, W. G., 881, 963.
Supino, 836, 841.
Suranyi-Unger, 827n., 829, 876n., 970.
Süssmilch, 259, 923.
Sweezy, 709n., 768, 899n., 900, 902.

T

Tarde, 854.
Tarshis, 766n., 767.
Taussig, 275n., 577, 887, **893**, 963, 974.
Taviani, 842.
Tawney, 498, 874.
Taylor, F. M., 895, 900, 963.
Thomas, 589.
Thompson, R. E., 329, 877n.
Thompson, William, **431f.**, 489, 915.
Thornton, 574.
Thünen, von, 296n., 314, 352, 353, **Chap. XVIII**, 466n., 610n., 813, 929.
Timlin, 766n.
Tinbergen, 707, 768, 784, 797, 797n.
Tintner, 695n., 784, 797n., 798, 898.
Todt, 823.
Tonelli, 842.
Tonini, 843n.
Torrens, 22, 293n., 296n., 299, 307.
Townsend, 586.
Toynbee, 176n., 314, 533, 727, 862, 870.
Treitschke, 818, 821.
Triffen, 708.
Trivero, 841.
Truchy, 850.
Tucker, 207, 208, 210, 212.
Tugan-Baranowsky, 673, 677n.
Tugwell, 718, 726, 897.
Turgot, 179n., 184, 186, 190, 191, 193, 194, **195f.**, 203, 204, 207n., 210, 212, 236, 242, 607, 923.
Tuttle, C. A., 963.
Tuttle, H., 883n.
Twiss, 112, 973.

U

Unwin, 873.

V

Valenti, 839.
Varro, 80, 87.
Vauban, 160n., 173, 175.
Veblen, 495, 631n., 634n., 718f., **723ff.**, 728f., 732, 772, 774, 896, 963.
Verri, 202n., 832.
Villeneuve-Bargemont, 401, 973.
Villey, 848, 850.
Vinci, 842.
Viner, 763n., 796, 796n., 901.
Vito, 843n.
Voigt, 828.
Volta, 841.
Voltaire, 201.

W

Wagemann, 666n., 677n.
Wagner, Adolph, 505, 814, 815, 817, 821, **822**, 835, 852.
Wagner, Valentin F., 826, 974.
Wakefield, 466.
Walker, A., 877, 880, 881, 964.
Walker, F., 964.
Walker, F. A., 507, 574, 575f., 863, **880f.**, 883, 886, 903, 964.
Wallace, A. R., 874n.
Wallace, R., 260.
Wallas, 497, 872, 874.
Walras, A., 588.
Walras, L., 518, 599ff., 623, 659, 781, 782, 783, 784, 785, **786**, 788, 793, 848, 855.
Ware, 175n.
Wayland, 880, 964.
Webb, Beatrice, 872, 874.
Webb, Sidney, 496, 497, 499n., 872, 874.
Weber, Alfred, 823, 826.
Weber, E. H., 581.
Weber, Max, 816, **828.**
Wells, D., 497, 881, 964.
Welsford, 875.
West, 293.
Westerfield, 964.
Weulersse, 175n., 202n.
Weyland, 223n., 280.
Whately, 21, 513, 514.
Whewell, 527.
Whitaker, 973.
White, H., 964.
White, H. G., Jr., 695n.
Whittaker, 971.
Wicksell, **Chap. XXXIII**, 674, 687, 738, 744, 783, 785, 790, 793, 826.
Wicksteed, 623, 659, 744, 784, 785, **869**, 873.
Wiedenfeld, 827n.
Wiese, 820.
Wieser, von, **610f.**, 618, 620, 622n., 626, 629, 819.
Wilbrandt, 820, 828.
Willcox, 903, 964.
Willis, 903, 964.
Wilson, E. B., 666n.
Windelband, 816, 827f.
Wirth, 340, 818.
Wold, 797n.
Wolfe, A. B., 721, 965.
Wolff, J., 275.
Wolff, O., 818.
Worms, 854.
Wright, C. D., 965.
Wright, D. McC., 765n., 768, 775, 899n., 900, 902.

X

Xenophon, 66, 67, 923.

Y

Young, 244, 260.
Young, A. A., 873.
Yule, 874.

Z

Zeno, 5, 69f.
Zeuthen, 701, 707.
Zincke, 151.
Zorli, 835n.
Zuccarini, 839.
Zuckerkandl, 623, 815, 817, 819, 973.
Zwiedeneck-Südenhorst, 727.

INDEX OF SUBJECTS

A

Absenteeism, 80, 559.

Absolutism, 6, 22, 179f., 241, 310, 339, 410, 846f., 910.

Abstinence, **345f.**, 455, 503, 620f.

Acceleration principle, 674, **677f.**, 687, 688, 689, 855.

Advertising, 698, 703, 707, 711.

Aggregate, **745n.**, **749**, **776f.**, 785, 798, 873, 897.

Agnosticism, Economic, 818, 896, 918.

Agricultural improvements, Effects of, 295f.

Agriculture, 47f., 79f., 86f., 96, 137, 138, 176, 316f.; Surplus and, 182.

American Economic Association, 718, 719, 882, 885, 886.

American Economics, 315ff., 383f., 412, 506, 657, 700, 708, 739, 770, 819, 871, **Chap. XLIV.**

American universities, Economics at, 726, 772, 881f.

Anarchism, 261, 434.

Anticipation (*see* Expectation).

Anti-Corn Law League, 238, 330.

Applied Economics (*see* Art; *cf.* Politics, Economics and).

Arithmetical ratio, 262, 264, 266, 398, 833.

Art, Science and, 814; Economics as an, 63f., 112, 128, 138, 144, 343f., 354, 392, 534, 740, 814f., 945.

Artisans, regarded with disfavor, 48, 63, 79.

Austrian School, 27, 503, **607ff.**, 677, 680, 782, 785, 801, 819, 841, 893, 917, 918, 947.

B

Balance of trade, 122f., 142, 143, 154, 356f.

Banking School, 826 (*cf.* Currency School).

Basing points, 709, 716.

Bible, 37, 54, 98, 103, 324.

Biology, Economics and, 326, 532, 725, 862, 866 (*see also* Organism).

Bourgeois Socialists, 426ff.

Brahmanic law, 43f., 51.

Bretton Woods Agreement, 771.

Business cycles (*see* Cycle Theory).

C

Cambridge School, 863, 864, **865ff.**, 918, 931.

Cameralism (*see* Kameralism).

Canon law, 98.

Capital: Definition and function, 157, 191, 303, 316, 320, 333ff., 368f., 382, 392, 393f., 409, 456, 485, 488f., 560ff., 660, 761, 878, 889, 901n., 936; Fixed *vs.* circulating, 288f., 493, 669, 671, 675, 686, 749n., 758; Productivity of, 134, 138, 191, 303, 555f., 619f., 761, 894; Relation to labor, 303, 320, 333ff., 367f., 399, 428, 431f., 435, 454f., 485, 563, 761.

Capital goods and cycles, 670ff.

Capitalism, 675, 676, 748, 772f., 772n.

Cartels, 676, 696, 698.

Caste, 47.

Catheder Socialisten (*see Katheder Socialisten*).

Causation in Economics, 543f., 549, 550, 652, 663, 693, 694, 772, 799, 804, 807 (*see* Laws, Nature of economic).

Charity, 42, 95.

Chrematistics, 63f., 392.

Christianity and Church, Economics and, 5, 34, 41, 52, 54, **94f.**, 212.

Circular flow theory, 174, 188f., 393f., 669, 685, 687, 740, 744n., 751f., 753, 947f.

Civil law, Economics and (*see* Roman Law).

Classes, 63, 151, 222f., 272, 285f., 295, 305, 427, 485, 487f., 724f., 886, 913 (*see also* Labor class); Physiocrat's four, 187.

Classical School, 14, 23, 131, **243**, 273, 375–80, 390, 413f., 505, 510f., 520, 581, 627, 629f., 648, 653, 669, 671, 691, 739, 743, 746, 749, 781, 803, 817, 818, 823, 834, 860f., 866, **910ff.**, 918, 925.

Collective bargaining, 696.

Collectivism, 779, 783, 784, 843, 859, 946.

Colonies, 125.

Colonization, 60, 135, 466.

Commerce, 79f., 183 (*see also* Foreign trade, Free trade, Regulation).

Communism and Communal Property, 5, 60ff., 94, 105, 259, 263, 434, 436, 465, 823, 843.

Competition, 45, 115, 250–51, 400, 432f., 529, 695f., 703, 712, 716, 888; Pure, 703, 709.

Conjuncture, 485f., 649.

Consumption, 16, 358, 383, 394, 456f., 557, 566, 594, 745, 754, 757, 890, 909, 930.

Consumption Economics, 744f.

Continuity in economic thought, 5, 40, 83f., **922ff.**

Contract, 75.

Cooperation, 839, 840, 854.

Corn Laws, 125, 127, 222.

Corporations, 470, 676, 696, 878, 882, 903, 922, 938f.

Corporativism, 843, 844.

Cosmopolitanism, 22, 210, 213, 372, 408, 414, 541f.

Cost, Nature of, 158, 345, 346, 358, 452f., 492, 586, 612ff., 632f., 642, 653, 683, 805, 861, 899, 900, 912, 931, 947 (*see also* Value).

Credit, 120, 437, 457, 517, 518, 542, 661, 668, 671, 672, 676, 677, 679, 681, 683, 696, 724, 741f., 751, 758, 825, 869, 898, 936.

Crises, 428, 429, 457, 482, 669f., 724 (*see* Cycle Theory).

"Cumulative process," 661, 673.

Currency School, 671f., 674, 826.

Cycle Theory, 665, **Chap. XXXIV**, 825, 842, **855f.**, 869.

D

Deduction (*see* Method).

Demand, effective, 661, 745, 748, 750, 754, 825.

Demand and Supply, 131, 139, 185, 186, 222, 273, 344f., 397, 451f., 459, 566, 642f., 697, 699, 715, 760, 771, 774, 803, **804f.**, 864, 865.

"Demand Price," 453, 642, 654f.

Democracy, 54, 63, 72, 771, 897, 898, 932.

Depression Economics, 670, 673, 677, 684, 690, 700, 718, 726, 738, 739, 746, 769, 869, 897.

Desire as an economic force, 650, 679, 696, 759, 760, 781, 899, 947.

Devaluation, 738, 740.

Differences and Differentials, 703, 713, 715, 716f., 867, 877, 880, 928, 939.

Diminishing returns, Laws of, 266f., 277, 369, 688, 891, 893, 929.

Diminishing unit cost, 697, 698, 699.

Diminishing utility (*see* Utility).

Distribution, 285ff.; Relative importance in Economics, 184, 285, 308, 356, 726, 806; Carey's

scheme, 320f.; Clark's scheme, 889; Keynes's scheme, 760; Marshall's scheme, 645, 653; Physiocratic scheme, 188f.; Ricardian scheme, 291f.; Rodbertus' scheme, 481f.; Sismondi's scheme, 393f.
Division of labor, 32, 57f., 84, 208, 216f., 386, 410, 416f., 907.
Domains, 150, 161, 162.
"Domestic System," The, 214, 921.
Dualism, 18–20, 625, 629, 649f., 690.
Duopoly, 697, 702f.
Dynamics, 679, 688, 794, 898, 915, 928, 938.

E

Econometrics, **796ff.**, 896, 898.
"Economic man," 233, 307, 584, 609, 618, 650, 728, 910 (*cf.* Rationality, assumption of).
Economics: Definition and scope, 63f., 71, 138, 157, 159, 308, 343f., 392, 441, 449f., 528, 639–41, 827, **934f.**, 945, 947f.; History of, 3, 4ff., 907ff.; Polity and, 157; Practical influence, 4, 127, 202f., 236f., 419, 709, 719; Social sciences and, 5f., 50, 327, 907, 934f.
Emigration and immigration, 146, 267, 269f., 317n., 466n., 530.
Employment (*see* Full employment).
Encyclopedists, The, 12, 197.
Entrepreneur, 355, 356, 528, 563ff., 622, 648, 653, 663, 678, 679, 680, 711, 715f., 762, 877, 880, 937; Entrepreneur viewpoint, 452, 475, 599, 613, 714f., 895, 912.
Environment, Influence of, 4, 9, 11, 67, 93, 100, 102, 115, 120, 129, 149, 175, 190, 258, 285, 313, 412, 426, 448, 538, 563, 639, 737, 749, 832, 847, 876ff., 893, **920f.**
Epicureans, 12, 70.
Epigones, 27, 818.
Equal or equitable distribution, 748, 759, 821, 868 (*cf.* Wealth, Inequalities in).
Equation of Exchange, 306f., 585, 602f., 753, 781f., 786, 919.
Equilibrium, 643, 653, 680, 691, 704, 748, 789, 791, 794, 802, **806f.**, 838, 875, 917.
Ethics and Economics, 6, 9, 12, 29, 68, 70f., 77, 99, 129, 217, 234, 354, 371, 392, 651, 771, 784, 788, 803, 821, 828, 844, 862, 864, 868, 872, 885, 888, 896, 907, 910, 912, 914, 917, **924f.**, 929, 932.
Evolution, Economics and, 439f., 525, 528f., 537, 638, 725, 862, 864, 917 (*see* Sociology).
Exchange, Place of, in Economics, 356, 359, 450, 514, 924.
Expectation, 661, 662, 678, 679, 713, 742, 752, 763, 775, 789, 791, 800.
Experimental approach, 729, 731, 774, 897, 898.
Exploitation of labor class, 224, 399f., 428, 431f., 435, 481, 488, 670, 675, 676, 706, 717, 761, 929.
Ex post, 691, 694, 791, 799.

F

Fabian Socialism, 872, 874.
Factory System, The, 214, 285, 921.
Fascism, 145, 707, 830, 843 (*see* Totalitarian).
Fatalism, 51, 53, 79.
Feudalism, 92, 117, 161.
Final utility (*see* Marginal utility).
Finance, Public (*see* Taxation) Economic thought and, 32f., 173, 184.
Firm, Economics of the, 697, 703, 705f., 711.
First International, 496.
Forced savings, 682, 683, 686, 738.
Forecasting and economics, 694, 777, 779, 799, 807.
Foreign trade, 306f., 349, 457f., 796, 943; Attitude toward, 52, 118, 121ff., 209, 413, 947; Reg-

ulation of (*see* Regulation, *and* Protection).
French Economics, 330ff., 355ff., 707, **Chap. XLII.**
French Revolution, 175, 407, 426, 462, 832.
Full Employment, 659, 743, 748, 751, 753, 754, 773, 899.
Fungible things, 101.

G

General equilibrium theory, 679, 691, 708n., **Chap. XXXVIII**, 843, 898, 899, 919, 948.
Geometrical ratio, 262, 263, 325, 834.
German Economics, 243, 351ff., 404ff., 504f., 537ff., 558ff., **Chap. XL**, 727, 834f., 867, 885, 911; Germanic contributions, 92f., 675f.; Influence, 851, 862, 882, 895; Kameralism and, 165, 923; German universities, Economics at, 355, 814.
Gild (or Guild) Socialism, 498, 874.
Gilds, 103, 104, 105f., 115, 151, 156.
Gluts (*see* Overproduction).
Gold Standard, 686, 737, 738, 843, 850.
Goods, Different orders of, 591, 609, 682, 686.
Government, Functions of, 124f., 181, 229ff., 279, 337, 355, 386, 399, 427f., 467, 468ff., 758ff., 821, 821n., 838, 868, 891 (*see also* State, Importance of).
Greek Economics, 56ff.
Gresham's Law, 153.
Gross national product, 751.

H

Habit, 557, 675, 676, 707, 716, 719f., 724ff., 892.
Harmony of interests, 178ff., 210, 321, 332ff., 430, 746, 771, 913, 927 (*cf.* Classes; Interventionism).
Hebrews, 39ff., 72.
Hedonism, 583, 599, 623f., 631, 650f., 723, 864, 892, 896, 912, 934.
Hindu economic thought, 39ff., 72.
Historical method, 23, 209, 354, 400, 529, 534, 535, 539, 540, 542, 543, 545, 547f., 549, 852.
Historical School, 23, 400, 530, 531, 533, 537ff., 722, 815, 817, 819, 827, 830, 835, 851, 862, 873, 894, 914f., 916.
History, Economic interpretation of, 56f., 487, 838.
Hoarding, 756.
Holding companies, 676.
Holism, 726, 898.
Humanism, 91, 114, 941.

I

Idealism in Economics, 8ff., 37, 51, 198, 232, 314, 405, 471f., 498ff., 625ff., 690, 726, 745, 778, 820, 824, 868, 879, 890, 904, 911, 914, 926.
Immaterial factors and immaterial wealth, 354, 357, 359, 409, 417, 517, 561.
Imperfect competition, 705ff., 869.
Improvements, Effects of, 295f.
Imputation, Valuation by, 583, 591, 611.
Income Economics, **750f.**, 897.
Increasing returns, 348, 891.
Independent domestic economy, 103, 107, 115, 143.
Indifference and indifference curves, 782, 784, 785, 787f., 794, 796, 801, 838, 899, 930, 949.
Individual *vs.* social interests, 58f., 143, 160, 222, 382, 384f., 399, 559.
Individualism in Economics, 11, 74f., 143, 180f., 379, 584, 626, 631f., 649, 692, 847.
Induction in Economics (*see* Method).
Industrial Revolution, The, 137, 139, 258, 285, 310, 425, 528, 570, 670.

Inflation, 680ff., 685, 737.
Inheritance, 59f., 428.
Innovations, 795.
Instincts, 209, 624, 625, 632, 721, **723f.**, 725, 728, 731, 927.
Institutionalism, 400, 471, 495, 700, **Chap. XXXVI**, 772, 823, 896, 898, 904, 920, 948.
Interest and prices, 661, 662, 672f., 673, 681.
Interest rates as a business control, 661f., 684, 686, 687, 737, 750, 759.
Interest theory, History of, 66, 132ff., 191, 210, 302ff., 368f., 455, 516, 618ff., 647, 660, 755, 761, 786, 795, 892, 893, 937.
International trade (*see* Foreign trade).
International value (*see* Value).
Interventionism, 747, 758, 851, 853, 868, 891, 944.
Intuitions, 741, 748, 766, 779, 864, 932.
Inventions, 385, 679, 877, 938.
Investment, 661f., 672, 673, 676f., 680, 682, 754, 778; Inducement to invest or Investment opportunity, 755, 892.
Italian Economics, 132, **Chap. XLI.**

J

Joint demand, 697.
Jurisprudence and Economics, 74ff., 149, 538, 540, 816.
Just price, 44, 45, 82, **99f.**, 104, 105, 128, 818, 908.
Justice, Economic and distributive, 438, 481f.

K

Kameralism, 148ff., 351, 505, 814, 923.
Katheder Socialisten, 820, 851, 855.
Keynesians, **766ff.**, 869, 898ff.
Kinked demand curve, 708.

L

Labor (*see also* Wages): Labor class and economic thought, 29f., 46f., 224, 426, 460, 862, 922; Dignity of labor, 46, 94, 106; Factor of production, 135f., 210, 215f., 359, 480f., 492; Painfulness of labor, 430.
Laissez faire, 4, 11, 193, 194, 195, 205, 212, 231, 357, 360, 469, 884.
Land (*see also* Rent): As factor in production, 136, 182, 205, 227, 316, 323, 365, 561, 877; As social basis, 49, 838f.; Relation to man, 18, 320, 448; Value of, 323, 335, 338.
Land banks, 126, 136.
Land nationalization and reform, 467, 788, 823, 838f., 874.
Landlords' interests, 226f., 271f., 296, 334, 453f.
Latifundia, 80.
Lausanne School (mathematical), 599f., 659, 781, 787, 837, 858, 919.
Laws, Nature of economic, 527, 529, 531f., 540, 542f., 547, 550, 639, 641, 728, 827, 837, 861, 867.
Legal arrangements and economics, 721, 727 (*cf.* Jurisprudence).
Liberalists, 847f., 850, 856, 857, 911, 916, 926.
Liquidity preference, 738, 753, 755, **756**, 758, 775, 825, 937, 949n.
Loanable funds, 680, 744, 795, 869.
London School, 743, **872f.**

M

Machinery, 214, 397f., 724.
Machttheorie, 820.
Macro-economics, 669, 686, 691, 692, 734, 749, 782, 843, 873, 897, 930, 945, 948.
Managed economy, 746, 748, 938 (*see* Social planning).
Manchester School, **237f.**, 339, 534, 818, 846.

Margin of cultivation, 292ff., 365f., 368; Extensive, 292f.; Intensive, 292f., 295, 369 (*see* Rent, Marginal productivity).
Marginal cost, 221, 644, 703n., 704, 706, 748.
Marginal productivity, 369, 503, 653, 659f., 715, 806, 878, 889.
Marginal utility, 503, 582, 584, 587ff., 608ff., 631ff., 654, 678f., 699, 801, 805, 817, 820, 841, 869, **888f.**, 899, 916, 918, 931, 939f.
Marginalism, 584, 889, 896.
Materialism in economic thought, 10ff., 78f., 139, 197f., 232f., 314, 487, 490f., 499, 625f., 690, 726, 894, 926.
Mathematical Economics, 358f., 518, 585, 586, 587ff., 596f., 599–604, 651, 659, 707, 714, 776, 778, 783, 796, 798, 800, 816, 824, 838, 843, 887, 892, 949 (*see also* Method).
Mature economy, 747, 769.
Measure of value (*see* Value).
Medieval Economics, 5, **91ff.**, 921.
Mercantilism, 26f., **111ff.**, 172, 174, 404, 668, 740, 747, 908, 923, 936, 941f.
Metaphysical stage, 25.
Method, 20ff., 309f., 327, 362ff., 386, 400, 473, 511, 523ff., 550, 628, 651f., **815**, 854, 861, 863, 866, 915, 916, 934; Abstract, 22, 309f., 362, 364, 523f., 628, 912; Concrete deductive, 473; Deductive, 21, 309, 362, 531f., 628; Inductive, 22f., 356, 386, 531f., 546f., 549, 867; Mathematical, 358f., 362, 596f., 599f., 816; Statistical, 21, 529.
Micro-economics, 692, 734.
Middle Ages, Significance of, 5, 34, 91ff., 410.
Monasteries, 104.
Monetary economics, **749f.**, 764, 777, 869, 898.
Money: Definition and nature, 65f., 76, 101ff., 210, 816; "Neutral," 683, 749; Origin and use of, 65f., 76n., 101n.; Value or purchasing power, 103f., 429f., 603, 640, 677, 760n., 805, 948 (*see also* Prices); Labor currency, 429f., 437, 483; Foreign trade and, 115f., 119f.; Regulation of exports of, 103f., 153, 158.
Money and cycles, 677, 680f., 686.
Monopolistic competition, **Chap. XXXV**, 805, 858, 897, 948.
Monopoly, 152, 227, 347f., 562, 697, 702, 705, 710, 868, 891, 928, 944; In medieval towns, 104ff.
Monopsony, 706.
Moral sense, 70, 209, 214, 864.
Mosaic law, 41f., 46f., 50, 51, 101.
Multiplier, 689, **756**, 764, 775, 785.

N

National income approach, 670, 685, 734, 765, 773, 898, 920.
National lines, Significance of, 53n., 141, 408, 414, 944f.
Nationalism, 379, 403ff., 770, 823, 824, 884, 908, 914.
Natural prices, rates, etc., 26, 64, 67, 190, 191, 222, 300, 368, 660, 661, 889.
Natural science, Progress in, and economic thought, 179–80, 524, 581f., 862, 907, 908.
Nature: Bounty of, 65, 182, 271, 297; Law and philosophy of, 5, 64, 74, 78, 98, 178ff., 234f., 253, 313, 449, 908, 911, 923.
Navigation Acts, 124, 127, 141, 142.
Negativism, in economic thought, 203, 240, 531, 539.
"New Deal," The, 9, 12, 404, 424, 719, 766, 770, 771, 903.
Neo-Classicism, 637ff., 657, 665, 691, 782, 820, 837, 858, 865ff., 873, 896, 897, **916ff.**, 931, 942.
Neo-Malthusianism, 282.

Neo-Romanticism (*see* Universalism).
New Welfare Economics, 859, **899f.**
Non-competing groups, 861.
Normal, 643, 662, 691 (*see also* Value, normal).
Numéraire, Money as, 783, 786.

O

Objectivity in economics, 716f., **930ff.**, 946f.
Oligopoly, 702, 708.
Ophelimity, 837.
Opportunism, 234, 496f., 874.
Opportunity cost, 519, 584, 663, 742, 750, 772, 778, 782, 795, 796, 804, 891, 895, 929, 931.
Optimism in Economics, 13f., 181, 313f., 373, 471, 535, 650, 723, 779, 847, 876, 891, **925f.**
Optimum, 696, 700, 740, 783, 784, 788, 872, 874, 899, 900, 919, 944.
Organism, Society as an, 9, 408, 498f., 547, 649, 726, 731, 824, 871, 888f., 917.
Oriental economic thought, 39ff., 72.
Overinvestment, 678f., 681f.
Overproduction, 15, 272, 356, 395f., 457, 667ff., 672f., 692.
Oversaving, 674, 676, 747, 872.

P

Pareto's Law, 837.
Parsimony and frugality, 124f., 133, 383, 556.
Period analysis, 393f., 660, 662, 669, 680, 752, 789, 791ff.
Personality of man, 51, 75, 93f., 95, 129, 433.
Pessimism in economic thought, 13f., 255, 296, 297, 762, 911, **925f.**
Philosophy and Economics, 8ff., 139f., 178f., 196ff., 232f., 307f., 326f., 377, 470ff., 498ff., 537, 623ff., 638, 827, 873, 890, 912, **933.**
Physiocrats, 79, **171ff.**, 316, 387, 513f., 519, 566, 740, 783, 908f., 924n.
"Policy," 747, 870, 884.
"Political arithmetic," 112, 770, 898, 936.
Politics, Economics and, 30f., 157f., 540, 903, 935.
Polizei, 814.
Poor, The, in economic thought, 42, 49, 103, 124, 269, 340, 426, 594.
Poor laws, 259, 343.
Population, 60, 103, 124, 134f., 150, 158f., 160, 164, 190, 210, **257ff.**, 297, 302, 318, 324ff., 336, 393, 398, 455, 460, 463f., 659, 664, 669, 834, 877, 894, 910.
Positivism, 853, 856.
Price (*see* Value); Price system, 240, 388, 390, 642, 909; *vs.* Value, 787, 804, 830, 932, 947f.
Price Economics, 663, 691, 696, 699, 709, 714f., 742, 750, 776, 830, 893, 895, 904, **947f.**
Prices, 99f., 104, 115, 258, 459f., 534, 658.
Probability, 714, 747, 752, 797.
Production, 65, 183, 204; Factors of, 135f., 174, 645, 760, 871f. (*see also* Labor *and* Land); Relative importance in Economics, 184, 214f., 356, 392.
Productive and non-productive classes, 136f., 183, 187, 195, 206, 216, 273, 316, 354, 418, 453ff.
Produit net, 182ff., 188, 200, 388.
Profits, 225f., 302ff., 455f., 460f., 563ff., 648, 653, 705, 762, 880, 893, 916, 928, 937ff.
Propensity: to consume, 675, 687, 689, 745, 746, **755**, 756, 764, 825; to save, 383, 675, 688; to truck and barter, 216, 696, 746.
Property, Private: Basis of, 180, 434f., 463, 467, 830; Economic thought and, 74, 93, 427, 429, 434f., 439, 676, 691, 724, 761, 894, 914, 922.

Protection and tariffs, 151, 315, 338, 372, 419f., 423, 748, 818, 874, 878.
Psychological factors, 679, 804, 805, 893, 910.
Psychological School, 586, 819.
"Pump priming," 757n., 898.
"Purchasing power," 661f., 684, 685, 758, 774f. (*cf.* Demand, effective).

Q

Qualitative values, 827, 829, 932.
Quantity Theory (*see* Money), 307, 685, 737, 750, 892, 897.
Quasi-rent, 647f., 867.
Quietism, 77f.

R

Rarété, 600, 602, 781, 787.
Rationality, assumption of, 179f., 197, 198, 248ff., 307f., 470f., 650, 705f., 709, 710, 714, 720, 787, 804.
"Reciprocal demand," 742 (*see* Equation of exchange).
Re rustica, Scriptores de, 80, 86f.
Reformation, 34, 91.
Regalia, 150, 161ff.
Regulation: Of everyday life, 41, 51, 59; Of industry and commerce, 45, 54, 59, 82f., 105, 123ff., 127, 146f., 316, 885.
Relativity, 6, 211, 533, 538, 542f., 720, 866, 885, 922.
Religion, Economic thought and, 50, 128f., 409 (*see also* Bible *and* Theology).
Renaissance, 34, 114, 941.
Rent, 135, 182, 205, 226f., 271f., 292ff., 322ff., 334, 365f., 453f., 484f., 525ff., 564, 647, 867, 890, 894.
Representative firm, 646, 654, 699.
Residual claimant, 303, 306, 715, 939.
Risk, 225, 304, 564, 648, 762, 795, 938.
Roman economic thought, 73ff., 93, 234.
Roman (Civil) law, 93, 163f., 436, 923.
Romanticism, 405f., 423, 824.
Roundabout process, 620f., 682, 937.
Royal Economic Society, 863.

S

Saint-Simonians, 427f., 446.
Saving, Nature of (*see* Parsimony; *also* Abstinence), 736, 748, 754, 756.
Saving and investment, 661f., 675, 679, 680, 681f., 687, 689, 692, 742, 743, 744, 748, 751, 753, 754, 758, 791, 819.
Savings and capital, 385, 503, 556, 648, 660 (*see* Abstinence).
Say's Law, 356f., 753.
Scarcity and value, 185, 286, 344, 451, 928, 930 (*see also* Demand and Supply).
Scepticism (*see* Agnosticism).
Scholasticism, 92, 97f.
Second International, 496.
Secular stagnation, 660, 688, 693, 738, 746, 758, 767, 778.
Self-interest, 62, 140, 200, 208, 210, 212f., 230f., 373, 385, 469, 695, 724.
Single tax, 192, 882.
Slavery, 80, 94, 96, 921.
Social Democratic Party, 497.
Social heritage, 726, 772, 928.
Social organism (*see* Organism).
Social planning, 144, 720, 731, 747ff., 890, 897, 920, 946.
Social point of view in Economics, 20, 53, 58f., 358, 384f., 807, 943.
Social security, 748.
Socialism: Agrarian, 192n., 502; Christian, 54, 823, 857, 874; Professorial, 820, 823, 851, 855; Revisionist, 496f.; State, 479, 480ff., 641, 841, 854; Relation to

Economics: reaction upon Economics, 360, 438f., 462f., 480, 500ff., 521, 581, 691, 929; Misinterpretation of economists, 224, 495f.; History of Socialistic ideas, 54, 399, 425ff., 479ff.. 820, 874, 899, 911, 914.

Society, Concept of (*see also under* Organism), 19f., 53, 58f., 385f., 420, 505, 543.

Sociology, and Economics, 5f., 638, 718, 723, 824, 828, 838, 840, 852, **853f.**, 917, 935.

Solidarité, 854f.

Sophists, 12.

Spatial relations, 708, 708n., 823, 826.

Speculation, 672, 676, 878.

Stages, Industrial, 26, 415, 418f., 440, 482, 488, 543, 724f.

Stagnation (*see* Secular stagnation).

State, Origin of, 56f.; Importance of, 58f., 117f., 408, 501, 821, 830, 883, 884.

Static *vs.* dynamic, 744, 865, 889f., 928, 938.

Stationary state, 255, 460.

Statistics, 21n., 112, 259n., 311, 598n., **796ff.**, 815, 816, 847n., 903.

Stockholm School, 785, 790f.

Stoics, 74f., 77f., 208.

Subjectivism and subjective point of view, 349, 354, 582f., 607ff., 629f., 786, 819, 895, 896, 898, 899, **930f.**, 934, 936, 938.

Subsistence, Minimum of, 268, 299.

Substitutes and Substitution, 702, 705, 787, 794, 801, 802.

Supply (*see also* Demand and Supply), 209, 344f., 451, 597f.

"Supply price," 642, 655.

Surplus, Consumers', 648, 930.

Surplus value, 182, 306, 368, 432, 435, 484, 490f., 493, 871, **927ff.**

Swedish School, 662, 790f.

Symmetry, Assumption of, 704.

Syndicalism, 497.

T

Tableau Économique, 187ff., 923.

Tariffs (*see* Protection).

Taxation, 103, 116, 137, 160, 163, 173, 191f., 195, 210, 228, 623, 759, 765, 871n., 895.

Technocracy, 731, 732.

Technological conditions, 724, 767, 800, 803, 806 (*cf.* Machinery).

Theological stage, Comte's, 26, 39.

Theology and Economics, 26, 40, 98, 178, 199, 280, 324, 409 (*see also* Socialism, Christian).

Time, Interest and; "Time preference," 346, 516, 620, 679, 680, 694, 892.

Time periods in economic theory, 248, 520, 643, 652, 654, 655, 660, 663, 687, 693, 694, 699, 713f., 717n., 744, 752, 782, 789, **792f.**, 806, 936 (*cf.* Period analysis).

Totalitarian or authoritarian state, 788, 824, 827, 838, 844, 899–900.

Towns and economic thought, 104f.

"Treasure," Importance of, 119f.

U

Unearned increment, 467, 502, 928.

United States (*see* American).

Universalism, 824, 941 (*see also* Spann in Index of Names).

Universities and Economics, 149, 156, 814, 851f., 863, 882 (*see Verein fur Socialpolitik*).

Underconsumption, 269, 394f., 401, 667ff., 674ff., 684f., 692.

Underconsumption cycle theories, 669ff., 674ff., 684ff., 746, 825, 872.

Underemployment equilibrium, 741.

Unequal distribution, 670, 736, 773.

"User cost," 742.

Usury, 41ff., 66, 76, 97, 101f., 132f.

Utilitarianism, 16, 209, 233, 235, 247–53, 307f., 445f., 462, 470f., 531, 623f., 864, 865, 867, 910, 912, 940.

Utility, 11, 81, 82, 100, 128, 131f., 184, 217, 248f., 311, 320, 332, 357, 470, 483, 500, 503, 594f., 930; Diminishing utility, 248, 346, 581, 582, 590, 679, 913; Marginal (*see* Marginal utility).

Utopia and Utopists, 114, 426f., 746.

V

Value: Cost and, 82, 96f., 99, 186f., 218, 345, 514, 597f., 611ff., 618, 642, 644, 653f.; Exchange value, 65, 129f., 131f., 184f., 217f., 513–19, 864; In international trade, 307, 458, 864; Intrinsic and extrinsic, 128, 129, 131f.; Labor-cost theory, 130f., 218, 287f., 436, 489f., 566f., 597, 614, 761; Measure of, 219–21, 273, 290, 611; Normal, 130, 132, 286, 451f., 643, 654; Philosophy and, 16, 499f.; Service theory, 332f., 515; Subjective, 16, 128, 132, 587ff., 607ff., 615f. (*cf.* Subjectivism); Utility and, 131f., 184, 186, 209, 211, 217, 286, 311, 332, 357, 492, 556f., 587ff., 607ff., 628, 867, 888, 893, 895 (*cf.* Utility).

Value, History of theory of: Austrian School, 607ff.; Bastiat, 332f.; Cairnes, 861; Carey, 320; German, recent, 817f., 819f., 824; Greek, 65; Jevons, 596f.; Keynes, 759; Lauderdale, 556f.; Marshall, 642f.; Marx, 489f.; Macleod, 516f.; Mercantilists, 128ff.; Mill, J. S., 450ff.; Physiocrats, 184ff.; Ricardo, 286ff.; Roman, 81f.; Say, 357; Scholastics, 96f., 99f.; Senior, 344f.; Smith, Adam, 217ff.; Thünen, von, 367.

Verein für Socialpolitik, 546, 820, 885.

Volitional psychology, 879, 892, 895, 904.

W

"Wage unit," 745n., 750, 754, 759, 760n., 761, 776, 785, 900.

Wages, 135, 189f., 223f., 226, 299ff., 348, 367ff., 454f., 893; Subsistence and, 190, 223, 299, 370, 480, 481, 485, 646f.

Wages-Fund, 224, 301, 311, 348, 354, 454f., 483, 535, 562f., 570ff., 863, 878.

Wants, Importance of, 15, 58, 64, 82, 100, 130, 208, 434, 457, 608; Indefinite expansibility, 15, 344, 396, 925.

War, Cycles and, 669, 677, 685; Economic Theory and, 33, 118, 144, 150, 258f., 285, 390, 403f., 736f., 750, 769f., 781, 824, 825f., 843, 851, 858, 862, 870, 879, 882, 884, 885, 896f., 898, 903, 935, 936, 943.

Wealth, Attitude towards, 52, 68, 77, 96, 417; Inequalities in, 68, 173, 429, 460, 462, 481, 670, 736, 821, 837; Nature of, 119f., 160, 173, 174, 183f., 290f., 317, 357, 381f., 392, 450, 520, 599 (*cf.* Equal or Equitable Distribution).

Welfare and Welfare Economics, 776, 870f., 893, 919, 922 (*see* New Welfare Economics).